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DEVELOPMENT ECONOMICS AFTER 40 YEARS

Essays in Honor of Peter Bauer

Basil S. Yamey	Peter Bauer: Economist and Scholar
Peter Bauer	The Disregard of Reality
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INTRODUCTION

DEVELOPMENT ECONOMICS AFTER 40 YEARS

James A. Dorn

> The shortcomings prevalent in much of economics generally are especially prominent in development economics. In the mainstream development literature they have been combined with disregard of evident determinants of economic achievement, such as personal qualities and social and political arrangements. The role of external contacts in extending markets and widening horizons has also been largely ignored. . . . These lapses are not merely of academic interest. The analyses or studies lead to the espousal and implementation of policies which are inappropriate in terms of their proclaimed objectives.
>
> —P. T. Bauer[1]

Dissent on Development

For more than 40 years Peter Bauer has explored the economic, social, and political landscape of underdeveloped countries, seeking to better understand the causes of poverty and material progress. His pioneering studies of the Malayan rubber industry and West African trade led him to question and eventually overturn many of the commonly held beliefs of development economics. In particular, his case studies refuted the notions that poverty is a vicious circle, that there is by necessity a widening gap between rich and poor countries, and that central economic planning and large-scale capital investment are prerequisites for growth. His studies also led him to conclude that foreign aid, restrictive immigration and population policies, and trade barriers typically hinder long-run advancement.

In his dissent on the state of development economics, Bauer has criticized orthodox development economists for ignoring important

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[1]Bauer (1981, p. 259).

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individual differences in economic aptitudes and motivations, for failing to consider the role of institutions, for relying on simple statistical relationships to explain the many-faceted development process, and for neglecting basic economic principles. In his own work, he has given new direction to development economics by recognizing the importance of noneconomic variables, including the role of property rights, in shaping individual incentives and behavior. And he recognized early on the weakness of the public-interest view of government, which permeates the theory and policy prescriptions of welfare economics and rests at the foundations of orthodox development economics.

According to Bauer (1984a, p. 30):

> Whatever insights may be gained from the theory of welfare economics, in fact the literature of market failure has been used largely as a collection of sticks with which to beat the market system. The critics who propose replacing the market system by political decisions rarely address themselves to such crucial matters as the concentration of economic power in political hands, the implications of restriction of choice, the objectives of politicians and administrators, and the quality and extent of knowledge in a society and of its methods of transmission.

It is to government failure rather than market failure that Bauer therefore attributes most of the shortcomings of development policy, especially to the failure of government to provide a stable framework for individual initiative. In this sense, his work in development economics has anticipated more recent developments in public choice theory and constitutional economics.

The fetish of development planners with economic equality and their neglect of the role of markets and prices in coordinating economic decisions and bringing about mutually beneficial exchanges has long been a theme in Bauer's critique of development orthodoxy. Once basic economic decisions become politicized and markets become subject to government control, the quest for "social justice" turns into forced transfers, many of which benefit state officials and special interest groups rather than the poor. Indeed, the use of coercion to remove economic inequality ends up attenuating personal freedoms and in the process dissipates a country's resources and lowers its standard of living while enriching those in the seats of power. The experience of black Africa offers sad testimony to the ill effects of development strategy based on socialist principles of national economic planning and egalitarianism.

Consequently, Bauer (1981, p. 8) sees a basic contradiction between the pursuit of economic equality, as an end in itself, and an open society:

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> In an open and free society, political action which deliberately aimed to minimize, or even remove, economic differences (i.e. differences in income and wealth) would entail such extensive coercion that the society would cease to be open and free. The successful pursuit of the unholy grail of economic equality would exchange the promised reduction or removal of differences in income and wealth for much greater actual inequality of power between rulers and subjects. There is an underlying contradiction in egalitarianism in open societies.

Dictating equality of outcome is therefore tantamount to destroying the wealth-creating properties of the competitive market process—a process that rests on the security of property and freedom of contract, including the expectation that the rewards and costs of alternative choices about the use of scarce resources will be concentrated on the individuals responsible for such choices. To neglect this linkage between the institutional framework and the process of wealth creation is, in Bauer's mind, to neglect reality.

In his major books[2] and numerous articles Bauer has made his distinctive mark on development economics, with economists from Amartya Sen to Thomas Sowell noting the significance of his work. "There are few branches of development economics in which Bauer has not had something interesting and important to say," remarks Sen (1982, p. 3). And Sowell (1984, p. 45) aptly notes:

> Professor Peter T. Bauer, of the London School of Economics, is one of those intellectually heroic figures who has stood fast against the fads and hysteria of his time. While the vast currents of "development economics" inundated us with "overpopulation" theories and "vicious cycle [circle] of poverty" doctrines that depicted massive foreign aid as the only salvation of the Third World, Bauer said "No!" loud and clear—but virtually alone.

That he is far from alone today in his criticism of conventional development theory and policy attests to the force of his arguments, buttressed by the mounting evidence against development planning as practiced over the last 40 years.

The essays in this Festschrift by leading economists from four continents are a testimony to the influence of Bauer's life work and a fitting tribute to his perseverance and discipline in questioning basic tenents of orthodox development theory and in bringing reality

[2]Bauer's books include: *The Rubber Industry* (1948); *West African Trade* (1954); *The Economics of Underdeveloped Countries* (with Basil S. Yamey, 1957); *Economic Analysis and Policy in Underdeveloped Countries* (1957); *Indian Economic Policy and Development* (1961); *Markets, Market Control and Marketing Reform* (with Basil S. Yamey, 1969); *Dissent on Development* (1972, 1976); *Equality, the Third World, and Economic Delusion* (1981); and *Reality and Rhetoric* (1984).

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to bear on difficult policy questions.[3] As *Basil Yamey* makes clear in his essay, Bauer is both an outstanding economist and scholar—as evidenced by his mastery of economic theory and the breadth and depth of his research.

In his essay, Yamey traces Bauer's interest in less developed countries (LDCs) back to his initial studies of Malayan rubber production (1948a, 1948b) and West African trade (1954a). In these early studies Bauer observed at firsthand that economic progress does not require outside capital and large-scale investment and that individuals in LDCs neither lack entrepreneurial skills nor are unresponsive to market incentives. Bauer's early studies of agricultural marketing schemes (for example, 1939, 1941, 1948c) also convinced Bauer of the adverse consequences of politicizing market pricing. These observations and insights later provided Bauer with the foundation for mounting his offensive against orthodox development economics as it evolved in the postwar era.[4] The technical elegance of neoclassical growth models and the historical determinism of stages-of-growth models did not blind Bauer to the reality of noneconomic variables in the process of material advance, or to the inconsistency of these models with what he had observed in the real world. Neither was he impressed with attempts by development planners to circumvent the competitive market pricing mechanism in instituting their blueprints for development.

Bauer's appreciation of market-determined prices as transmitters of information about relative scarcities and preferences, as well as his recognition of the incentive function of prices and profits, made him skeptical of state export monopolies in British West Africa (for example, 1954b, 1956) and of government schemes to stabilize the incomes of primary producers (for example, 1952, 1954c).[5] As Yamey makes clear, Bauer thought that such intervention was self-defeating and that pricing decisions are best left to the free play of market forces.

Nowhere has the politicization of economic development been more evident to Bauer than in the parceling out of foreign aid. Such

[3]The papers in this Festschrift, except those by Mancur Olson, Paul Craig Roberts, and Alan Walters, were originally presented at the Cato Institute conference **Development Economics after 40 Years: A Conference in Honor of P. T. Bauer,** held in Washington, D.C., May 1, 1986.

[4]For Bauer's own recollection of the influence of his early work on his later writings in development economics, see Bauer (1984b).

[5]Bauer became even more skeptical of government attempts to "stabilize" prices and incomes after considering Milton Friedman's article of December 1954, "The Reduction of Fluctuations in the Incomes of Primary Producers: A Critical Comment," which was published in the *Economic Journal* (see Bauer 1984b, p. 40).

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aid has often been used to enhance the wealth of Third World rulers and support their political ambitions rather than to promote the long-run economic health and independence of individuals in the LDCs. Such aid has also benefited domestic producers in donor countries, the so-called foreign-aid industry.[6] For these and related reasons, Bauer argued that without foreign aid there would be no Third World and perhaps no development economics—insights of major significance, says Yamey. In Bauer's words (1984a, p. 40): "The concept of the Third World and the policy of official aid are inseparable. The one would not exist without the other. . . . Thus, the Third World is a political and not an economic concept."

Bauer's penchant for bringing facts to bear on development theory led him to conclusions in conflict with mainstream development economics. Among the myths dispelled by Bauer, Yamey lists the notions that poverty is self-perpetuating; that contact with the West is detrimental to Third World development; that the terms of foreign trade necessarily deteriorate for LDCs; that government planning is the *sine qua non* of economic development; that population growth is a barrier to development; that escaping poverty in LDCs inevitably breeds balance-of-payments problems; and that without foreign aid economic progress in the Third World is doomed to failure.

Finally, Yamey points to Bauer's refusal to formulate a grand theory of development as a factor that distinguishes him from modern-day development economists who have searched in vain for such a unified theory. Economic development is a product of complex forces—a spontaneous process better left to individuals operating in the voluntary marketplace than placed in the hands of social engineers. Development policy that takes account of individual differences and establishes a framework for voluntary exchange and freedom of contract is therefore more likely to increase the material well-being of individuals than development planning aimed at achieving social justice via the redistributive state.

Reality Disregarded

In his provocative essay, *Peter Bauer* reflects on the retrogressions that have occurred in economics over the last 40 years as economists disregarded basic principles and evident reality. Bauer points to the "dollar problem" and the "vicious circle of poverty" as two early examples of retrogressions in mainstream development economics. In the first instance, economists disregarded the reality that the quan-

[6]For example, Donald May (1987, p. 12c) reported that nearly 80 percent of U.S. foreign aid returns to domestic producers.

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tity of dollars demanded and supplied depends on the price of dollars, that is, on the exchange rate. Any dollar shortage, therefore, should be viewed as temporary, with the speed of adjustment to an equilibrium exchange rate dependent on how free the foreign exchange market is to respond to changes in the underlying conditions of demand and supply. Likewise, balance-of-payments problems cannot be systemic if market forces are allowed to prevail and governments adhere to a consistent set of rules conducive to international stability. In the case of the so-called vicious circle of poverty or poverty trap, Bauer notes that economists disregarded the reality that poor individuals and countries have escaped poverty by hard work, thrift, and prudent investments.

Further retrogressions in economics took place in the postwar era with the widespread acceptance of the idea that Third World impoverishment is the result of commercial contacts with the West—implying that market exchange results in exploitation or is a negative-sum game. But this belief ignores the principle of comparative advantage and the fact that *voluntary* exchange is mutually beneficial. As Bauer reminds us, those LDCs having the least amount of trade with the West have also experienced the lowest living standards.

The indiscriminate use of mathematics and econometric methods in modern-day economics has also led to the disregard of reality, observes Bauer. In particular, the mathematization of economics has resulted in bypassing important noneconomic variables that are difficult to quantify, overlooking the relevance of history, and passing over the time dimension in studying the process of development. Cultural factors, personal beliefs, and ambitions, as well as property rights, are all difficult to quantify but play an important role in material advance. Moreover, Bauer emphasizes that in trying to apply the methodology of the natural sciences to the study of society, economists have misunderstood the essential difference between these areas of inquiry. As a result, mainstream development economists have offered policy proposals that are unrelated to reality.

Bauer also points to the disregard of reality that has occurred outside economics as those molding public opinion have tried to legitimize envy by calling for a massive redistribution of wealth from the United States and other developed countries to the Third World in the name of equality and social justice. These opinion leaders have chosen to ignore the reality that wealth is dependent on productivity and that massive redistribution destroys incentives to produce. Instead, they have relied on feelings of guilt to promote their own development plans designed to create a "New International Economic Order," supposedly devoid of self-interest. But pointing to differences in

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income and wealth without understanding the role of institutions, self-interest, individual abilities and attitudes, and a host of other important factors affecting material progress is to invite policies that inevitably undermine the very institutions and personal traits that have been instrumental in reducing world poverty and stimulating economic progress. As Bauer says, failure to look at the history of Western culture and its social and economic institutions, and to realize that the West itself was once underdeveloped, can only result in misguided development policy. Bauer therefore finds it disquieting that Western leaders have openly supported international organizations and Third World leaders advocating policies that are detrimental to private enterprise, embarrassing to the West, and unlikely to bring long-run prosperity to the populace of underdeveloped countries.

Along with the retrogressions that have occurred in economics and the evident disregard of reality that has plagued development policy, there has been what Bauer calls a "misuse of language." Nowhere has this been more glaring than in the use of the term "Third World," which is more of a political contrivance than a description of an existing homogeneous entity. And with such "noise" introduced into ordinary discourse, Bauer sees a further distortion of reality. Indeed, he warns that as the world turns from reality, it faces a new barbarism—one that depreciates the moral traditions of the West and the discipline necessary for progress. In Bauer's view, people in all countries would be better served by a return to reality and the use of ordinary language to describe that reality.

The Mathematization of Economics and Development

By treating economics as a precise science analogous to the natural sciences, mathematically oriented development economists—who rely on neoclassical growth models and simple statistical relationships to formulate policy proposals—have provided those ruling the Third World with a rationale for thinking that social engineering (fine-tuning the economy) is the optimal way to achieve economic development. In turn, the development process has in a sense become mathematized, subjecting a complex, highly individualistic process to the rule of "experts." National economic planning, with its emphasis on input-output models and large-scale social investment plans, has tended to be more popular with Third World leaders and their advisors than private ownership, market pricing, and entrepreneurs driven by the profit motive. The shortcomings of the mathematical/

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social-welfare approach to development policy have been its public-interest view of government and its lack of attention to the impact of institutions on economic development. Moreover, this approach to development policy has failed to come to grips with the importance of competitive markets as processors of information about wants, resources, and technology—data that are constantly changing and often not available to the "experts."[7]

Deepak Lal draws out some of the implications of the mathematization of economics and development policy. According to Lal, it is the rhetoric of economists as mathematicians and econometricians rather than the rhetoric of classical political economists that has dominated the field of development economics. This helps explain why Bauer's work received so little attention in the 1950s and 1960s. It was the failure of development policy based on mainstream development models in the 1970s and 1980s, says Lal, that forced attention on Bauer's analysis and observations. In his essay, Lal avoids the nirvana fallacy and takes a comparative institution approach to development strategy.[8] He examines the relative importance of the market and the state in the development process, and notes that both neoclassical economics with its positivist methodology and the new political economy offer useful insights. In his view, the choice of alternative development strategies—whether the market or the state dominates the policy agenda—ultimately depends on experience. And in his view, it is clear that the pendulum has swung too far toward the state.

With attention largely focused on mathematical economics and the rhetoric of positivist social-welfare theorists, such as F. H. Hahn, who operate in the Arrow-Debreu framework, too little attention has been paid to the insights of classical political economy and its more recent manifestations in public choice theory, neo-Austrian economics, property rights theory, and constitutional economics. As Lal notes, the new political economy with its emphasis on government failure—due to the self-interested behavior of public officials who function in a nonmarket, common property regime—has proven to be a powerful rival to the paradigm of market failure with its public-interest view of government. The ruling elite in the Third World ("mandarins," as Lal calls them), in formulating grand designs for development, have too often ignored the realities of self-interested political

[7]The implications of F. A. Hayek's classic article "The Use of Knowledge in Society" (1945) apparently have not yet been fully appreciated by most Third World rulers and their economic experts.

[8]On the difference between the "nirvana approach" to public policy and the "comparative institution approach," see Demsetz (1969, p. 1).

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behavior and the impossibility of duplicating the wealth-creating properties of competitive markets without establishing private property rights.

Today there is a wider appreciation of the informational and incentive advantages of the market pricing mechanism, observes Lal. But old habits of thought die slowly. Mathematical economics and mechanistic models of development continue to immunize brilliant minds against the insights offered by the new political economy.

Organization Size as a Factor in Development

In his paper, *Mancur Olson* examines a much neglected aspect of development economics, namely, the relationship between organization size and stage of development. Olson's argument is based on the perception that the technological and economic conditions in preindustrial societies are unfavorable to large-scale organization. Poor transportation and communication make localized production relatively more advantageous in most poor societies and increase the difficulty of monitoring and coordinating activities in large-scale organizations. The latter difficulty is most serious in activities, such as government, which require coordination over large areas. The lack of experience with large-scale organization, says Olson, generates cultural attitudes that are unsuitable to large-scale bureaucracy. Thus, he points out that nepotism and other forms of corruption were common in Europe in preindustrial times and are also characteristic in large bureaucracies in poor countries today.

According to Olson, cultural attitudes influence behavior considerably in bureaucracies, because the incentives facing individuals are often unclear and dependent upon the attitudes of others. These attitudes do not have as great an influence on individual behavior in markets, where the incentives facing an individual are usually less ambiguous. For Olson, trading in a bazaar in a poor country is not greatly different from that in the markets of rich countries. He accordingly rejects the commonplace contention that developing countries need different policies, with a lesser role for markets and a larger role for government bureaucracy, than developed countries. He argues that neither left-wing nor right-wing ideologies offer a satisfactory guide to public policy, but believes that the proper role for bureaucracy is smaller and for markets is larger in poor than in rich nations. Therefore, in spite of philosophical disagreements with Bauer, Olson concludes that Bauer's insights on the advantages of markets and the disadvantages of bureaucratic planning in developing areas have been profoundly valuable.

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The Role of Property Rights

The term "property rights," when broadly understood, encompasses "one's effective rights to do things and his effective claims to rewards (positive or negative) as a result of his actions. These rights help shape his set of opportunities and therefore the tradeoffs that confront him" (McKean 1972, p. 177). Among the factors that influence an individual's effective rights McKean includes "explicit contracts, tacitly understood contracts, ethical precepts, behavioral rules or customs, and tradition, as well as legislation" (p. 177). When these factors change, or when an individual *expects* them to change, the perceived costs and benefits of alternative actions will change, affecting the individual's choices. McKean therefore notes that "in appraising special tools to increase efficiency, one should examine what happens to property rights and appropriability in order to form realistic expectations about the effects" (p. 186).

An important element of Bauer's work is the emphasis he gives to property rights, broadly understood, in determining the rate of economic progress. According to Bauer ([1972] 1976, p. 75): "[E]conomic achievement depends primarily on people's abilities and attitudes and also on their social and political institutions. Differences in these determinants or factors largely explain differences in levels of economic achievement and rates of material progress." The key role of property rights in economic development is clearly brought out in the papers by *Alan Rufus Waters* and *Alvin Rabushka.*

Property Rights and Economic Growth

Waters points out that Bauer's work has helped fill the institutional void left by traditional development economics and that much can be learned from incorporating property rights into traditional economic analysis. Private property, characterized by the owner's exclusive right of use and transferability, makes individuals accountable for their uses of scarce resources and provides incentives to move resources to their highest-valued uses. These are important functions of private ownership and essential to meaningful economic growth. As Waters remarks, those countries with well-defined and protected private ownership rights in land, labor, and capital have tended to outperform those adhering to socialism and state planning. The vibrant forces of market competition—the risk of loss for inefficiency and the promise of reward for socially beneficial uses of property—have proven more successful in promoting material advance than the stifling hand of government.

The security of property is important because it generates an expectation that one can retain into the future the fruits of present sacrifices

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without state intervention in the form of oppressive taxation, regulation, or nationalization, notes Waters. By creating a climate conducive to the stability of ownership rights, LDCs can increase private savings and attract new investment, increasing their living standards—and conversely in those cases where private property rights are attenuated. Effective private ownership rights allow the flexibility needed for adapting to the dynamic process of economic growth by ensuring individuals the freedom to move their resources to higher-valued uses, adds Waters. Exchange opportunities are widened as a result, increasing individual wealth.

An important part of Waters's paper is his idea that "failure is a part of success." Attempts to conceal failure by instituting government subsidies, for example, destroy an important disciplinary force of the market—the imposition of costs on the owners of resources who fail to perceive changing patterns of trade. Economic growth cannot proceed without change, and change entails failure as well as success. In essence, failures tell us to move in directions that are now more profitable and that will yield net benefits to society over time. The role of the entrepreneur is to spot these new opportunities, and the profit/loss motive is instrumental in pushing him in the right direction. If state enterprises in LDCs are not allowed to go bankrupt, then an important element in the growth process will be absent, handicapping LDCs in their search for material advance. Thus, Waters notes with approval the recent focus on privatization as a method to stimulate economic growth.

Tax Policy as a Determinant of Development and Freedom

The legal structure of property rights is not as important as the *effective* structure of rights to use property, to sell it, and to capture the consequent rewards. In particular, as McKean (1972) emphasizes, *appropriability* is crucial in studying the impact of property rights on economic behavior; and in this sense the tax structure is of central importance. Tax rates and thresholds help determine the rewards an individual can take home from various actions and thus help determine his effective property rights. As such, tax rates and thresholds will have a bearing on an individual's uses of scarce resources. Supply-side economics has shown that high marginal tax rates that bite into income at a low threshold have significant disincentive effects on savings and investment decisions and labor-supply decisions, and that these effects can impede economic growth. Rabushka carries this theory to LDCs and gathers an impressive array of data to test the hypothesis that high marginal tax rates and low thresholds retard the development process. He also brings evidence to bear on the relationship between tax policy, economic growth, and freedom.

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From his careful survey of the tax policies of a number of LDCs, Rabushka reaches the conclusion that those countries with high tax thresholds and low marginal tax rates have had better records of economic growth than those with relatively lower tax thresholds and/or higher rates. Moreover, LDCs with higher growth rates have tended to have better records of protecting political and civil liberties than low-growth countries. In examining growth and freedom measures for 93 LDCs over a 22-year period, Rabushka found that "once economic growth exceeds 3 percent, political and civil rights scores significantly improve." This evidence is by no means conclusive, but it does point toward a link between taxation and freedom operating through the growth mechanism. As Rabushka notes, if low tax rates and high thresholds foster economic growth and if economic growth is a necessary condition for democracy and freedom, then those countries with growth-oriented tax policies should also be more open societies.[9] Future research no doubt will shed further light on this oft-neglected area of development economics.

The Bogeyman of Economic Inequality

Those who mold public opinion in the Third World and elsewhere have used economic inequality as a bogeyman to incite fear, anger, and envy in people and to press for equality as an end in itself. Little consideration has been given to the process by which income and wealth is produced, to the impact of forced redistribution on incentives and wealth creation, or to the allocation function of prices. Instead, the redistributive state has been looked upon as the instrument to obtain economic equality and social justice while fostering economic growth. The inherent contradiction of this "egalitarian vision" has long been a theme in Bauer's work and is further explored by *Karl Brunner*.

In his paper, Brunner notes the difficulties with the end-state concept of social justice as exhibited in the cry for economic equality—in contrast with the classical notion of procedural justice, which does not aim at equality of outcome but rather at establishing a framework for free choice. Like Hayek, Brunner argues that imposing an arbitrary, politically determined notion of end-state justice on a spontaneous market order tends to destroy the wealth-creating properties of that order.

The end-state notion of justice, says Brunner, is flawed by the "manna syndrome," as well as the underlying "sociological model

[9]Using tax data and data on political and civil liberties in 49 LDCs, Rabushka found no significant relationship between the *overall* level of taxation and his measures of freedom.

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of man" and public-interest view of government. Wealth creation is not independent of the institutional framework or exogenous to individual choices within that framework. Self-interest is a phenomenon that operates across the institutional spectrum, but with vastly different outcomes depending on the nature of the property rights structure. To ignore these facts and the nexus between production and distribution, says Brunner, is to invite social and economic disruption.

The implication of Brunner's analysis is that institutions matter. Development economics must take account of the effects of alternative property rights on incentives and behavior, and recognize that grand plans to redistribute income are bound to interfere adversely with the competitive market process—narrowing individuals' opportunity sets and lowering their wealth positions. Consequently, state action to achieve social justice (that is, a more equal distribution of income and wealth) via direct and indirect takings will have a negative feedback effect on economic growth. Furthermore, as Brunner observes, this negative effect will be compounded as political power becomes more unevenly distributed in LDCs pursuing so-called egalitarian policies, dampening the hopes for an open society. In sum, policies that call for massive redistributions of income and wealth are unlikely to achieve their stated goal of economic equality and in the process are likely to promote stagnation and attenuate personal and political freedoms.

Population Growth, Development, and Foreign Aid

Julian Simon considers the effects of population growth on economic development and examines the legitimacy of U.S. foreign aid for "family planning" programs in light of five criteria for foreign aid in general. According to Simon, there is no evidence that population growth is a drag on economic growth in the long run. Hence, government programs to control population growth with the hope of accelerating economic development are misguided. Moreover, insofar as such programs distract attention from the real sources of economic growth—especially the need for institutions supportive of market exchange and the price mechanism—they can harm the chances for development.

In the spirit of Bauer's work, Simon draws on the experiences of North and South Korea, East and West Germany, and China and Taiwan, as well as other countries, to illustrate that market-oriented economies generally have outperformed centrally planned and controlled economies; that economic development and population growth are not causally related; that relatively high population density is not incompatible with economic development but in fact facilitates it;

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and that increasing population density does not impede the rate of population growth. Thus, from a long-run perspective, Simon concludes that a larger population *can* have a positive effect on a country's standard of living—especially in open societies where individuals can pursue their economic interests with a minimum of state intervention.

With regard to "family planning," Simon sees nothing wrong with providing individuals with educational information to help them make more rational choices. But he is critical of official "family planning" when it is used as a propaganda tool to divert attention from government failure and to focus attention on population growth and market failure as justifications for foreign aid. In his view, individuals in poor countries do respond to price incentives and typically make rational family choices when they have to bear the costs of their actions.

To test for the legitimacy of foreign aid in the case of "family planning" programs, Simon offers the following criteria: (1) The aid should be based on the recipient's "need," especially as revealed by a means test; (2) the recipient nation should reveal a definite want for assistance in terms of the resources it is willing to allocate to family planning; (3) there should be no ill effects from the assistance, that is, the disincentives to work, save, and invest should not outweigh the positive income effect, and aid should not divert attention from a long-run development strategy based on sound economic principles and institutional reform designed to foster individual responsibility; (4) the aid should be utilized efficiently, which is less likely the greater the role of bureaucrats in the aid process; and (5) the aid should not sour the relationship between recipient and donor. From his evidence, Simon concludes that foreign aid programs for "family planning" generally have not met these five criteria. Such programs, says Simon, "may have more ill effects than good effects, and should not simply be viewed as a charitable act that improves the situation of poor people in poor countries."

Orthodox Development Policy: A Case of Government Failure

Orthodox development policy with its emphasis on government planning and foreign aid, rather than on market coordination and private investment, has failed in many areas. The papers by *George B. N. Ayittey*, *Paul Craig Roberts*, and *Alan Walters* offer three examples of policy failure—all of which can be viewed as the failure of government to lay a solid foundation for long-run economic growth by protecting private property rights and allowing market forces to

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register changes in individual preferences, resources, and technology. Government failure in the case of black Africa is examined in detail by Ayittey; Roberts discusses how government controls and foreign aid have discouraged direct foreign investment as well as private domestic investment in LDCs and turned many Third World countries into major debtors; Walters, meanwhile, points to the failure of government price "stabilization" schemes to achieve their proclaimed objectives. In each case, government officials have used their power base to politicize the development process.

The Experience of Black Africa

Although black Africa is endowed with abundant natural resources, its economic performance since independence in the 1960s has been dismal. Ayittey attributes economic atrophy in black Africa to the politicization of development policy and a fetish with orthodox development strategy. The political climate in post-colonial black Africa has hampered economic progress. Political leaders and their elites have disregarded traditional modes of production, interfered with market exchange by various controls and price-fixing schemes, coerced the peasant population, collectivized agriculture and nationalized other enterprises, and instituted destabilizing autocratic and kleptocratic forms of government. Overall, black African rulers have disregarded the role of property rights in the development process and suspended the free play of markets and prices. Under the spell of orthodox development policies and their own fascination with modernism, these rulers have embraced a "religion of development," says Ayittey—a body of beliefs about state-directed development planning that has not held up in the face of reality.

Nkrumah's socialist experiment provided a blueprint for the rest of black Africa, but the failure of this experiment is evident to Ayittey. The inefficient state enterprises and collectivized farms that dot the stagnant economic landscape of black Africa attest to the ineffectiveness of national economic planning under corrupt and autocratic governments. Political leaders in black Africa have engaged in rent-seeking behavior that has cost their peasant populations dearly, as illustrated so vividly in Ayittey's examples. Foreign aid in many cases has gone to enrich the elites and build their Western-style "monuments" rather than to assist the truly needy and promote meaningful economic growth. What these developments show, says Ayittey, is that black African rulers have lost touch with reality. Their unrealistic plans for economic growth and for imitating the West have blinded them to the fact that development must take place within the existing cultural and institutional framework and that economic progress is a slow and costly process.

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Development strategy based on state enterprises, import substitution, and deficit spending offers little hope for black Africa, in Ayittey's opinion. It is therefore time, says Ayittey, for black African leaders to adopt a new development strategy that takes account of black Africa's cultural and social institutions and provides a stable political environment in which markets, not planners, dominate. By abandoning the socialist blueprint for development, black African leaders will be able to utilize indigenous methods of production and once again enjoy the fruits of free trade and free markets—institutions, observes Ayittey, that "have always been part of black African traditions."

The Third World Debt Crisis

Under the influence of development experts, LDCs have become major debtor countries and their debts are crowding out development, argues Roberts. In his view, the Third World debt crisis is directly tied to orthodox development strategy with its emphasis on social investment planning and debt financing—and its bias against private ownership, market pricing, and direct foreign investment. Instead of relying on the decisions of private entrepreneurs—guided by the profit motive and prices reflecting opportunity costs—to direct investment funds to their most productive uses, LDCs have politicized investment decision making by placing investment decisions in the hands of state planners who have neither the information nor the incentive to direct resources to their highest-valued uses. Debt, not equity, has been the favorite password of Third World development planners.

The restrictions on equity investment in the LDCs and the waste of resources through social investment planning have constrained economic growth and compounded the debt problems of LDCs, notes Roberts. "It is no accident," he says, "that the reliance on planning and borrowing has culminated in the debt crisis." Moreover, given the statist policies of Third World governments, Roberts sees the activist lending practices of large Western banks in the Third World as sealing the fate of the debt crisis.

In the face of this crisis, says Roberts, the IMF's austerity programs—directed as they usually are to tax increases, price freezes, and import controls—work against long-run economic growth and do virtually nothing to reduce Third World indebtedness. Rather, such programs precipitate political unrest and are used mainly as preconditions for acquiring additional debt. The key to regaining financial stability and setting the stage for a healthy economy, suggests Roberts, is that LDCs undertake a *credible* policy of moving away from

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orthodox development strategy with its statist slant and toward a full-fledged market-oriented development policy. Such a policy shift would place responsibility where it belongs, on private entrepreneurs and other individuals acting within a private property regime. The lack of equity investment would then no longer be a barrier to development; and with the creative forces of domestic and international competition unleashed, economic growth would no doubt improve and help dissolve the debt crisis.

The Veil of Price Stabilization

The main point of Walter's paper is that what passes in theory as price "stabilization" is in reality simply a politicization of the pricing process that results in exploitation. He uses "moving average smoothing" (MAS) to illustrate the theory of price stabilization and points to experience with price "stabilization" in British West Africa, as well as European and American attempts at stabilizing agricultural prices, as examples of failed public policy. But his unveiling of the failure of price "stabilization" in Africa, Europe, and the United States merely serves to illustrate the general case against government price fixing, namely, that it interferes with free trade, distorts market prices, and redistributes income from politically less-favored to more-favored groups.

In Walters's view, price "stabilization" is just another word for price *control*. More specifically, price "stabilization" is used by politicians as a veil to conceal market forces, and thus to protect themselves and their favored interest groups from the reality of the marketplace. But the longer reality is evaded, the more costly the final adjustment is likely to be. Therefore, Walters observes that once entered into, price-fixing schemes will be difficult to exit. He concludes that, in practice, MAS policy has not promoted adjustment to world market pricing; it has merely provided "a veil of legitimacy and intellectual respectability for exploitation and inefficiency."

The Rhetoric of Development Economics

In the final essay of this Festschrift, *Donald McCloskey* examines the rhetoric of development economics and finds a variety of styles ranging from abstract mathematical reasoning to metaphor to straightforward reasoning based on observation and economic principles. It is the rhetoric of mathematical economics, however, that has played a key role in shaping orthodox development strategy, as was noted in reference to Lal's essay. Or, as McCloskey puts it, the "religion of Science" (in the sense of "Scientism") has been used to daze Third World governments into believing that social engineering is a fea-

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sible approach to economic organization—an idea incompatible with classical political economy.

In McCloskey's view, it is beyond doubt that rhetoric, in the classical sense of the "art of argument," is important in development economics. Words matter; and as McCloskey notes, "Rethinking development economics requires rewriting the words." One need only consider the many continuing controversies in economics in general, and development economics in particular, to see the weight of McCloskey's argument. The efficiency-equity debate discussed in Brunner's essay is one such example.

McCloskey also reminds us that the style of argumentation will be influenced by one's perceived audience. Bauer's nonmathematical treatment of development economics is no less rigorous from the standpoint of logic than the mathematical approach of social welfare economists, yet Bauer's words largely fell on deaf ears until the audience was in tune with his arguments. And, as Lal makes clear in his essay, that audience is growing, both because of the evidence that has come to bear on Bauer's arguments against orthodox development economics and because of the force of his style of argumentation.

All economists are rhetoricians in McCloskey's usage, but to be more than a mere advocate requires not only that the rhetorician argue correctly but that he be of sound character and not disposed toward falsehood and deception. It is in meeting the test of a "good" rhetorician in both these senses, says McCloskey, that Bauer deserves the recognition he is presently receiving.

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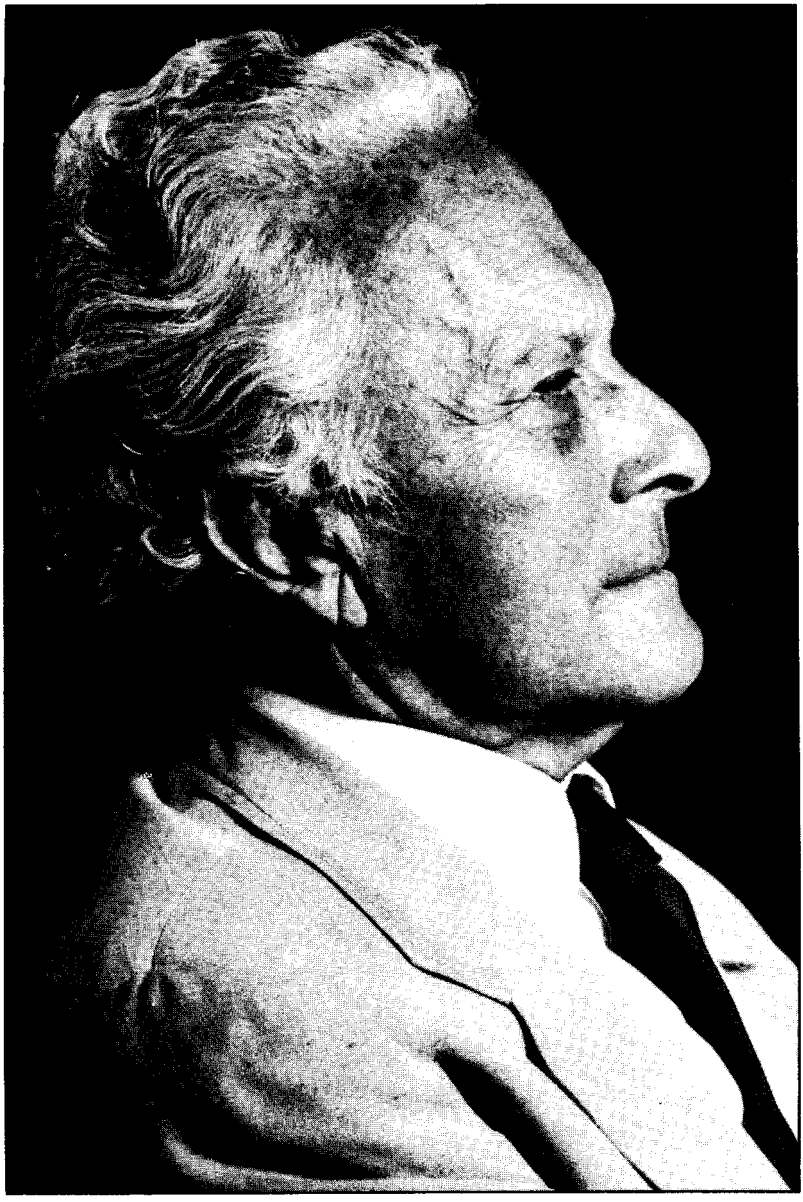

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Peter Bauer: Economist and Scholar

Basil S. Yamey

I find myself in something of a quandary. It is my allotted and agreeable task to consider Peter Bauer's contributions to development economics. But to assess these contributions is to praise their author. I have, indeed, come to praise Bauer—not, I am happy to say, to bury him: he is alive and well; and I can testify that he is as entertaining and productive as ever. Now—as the early 19th century author, Augustus Hare, emphasized, it is not proper for a gentleman to be praised to his face. It was for this reason that Hare crossed out, in his prayer book, all passages in which the Lord is praised. Peter Bauer is a gentleman—his membership of the British House of Lords is proof enough of that fact. Hence my quandary. My escape route lies in the fact that Bauer is both a scholar and a gentleman. And it is his scholarly work I will be talking about—and I will not even allude to his great personal qualities which are so evident to all who know him well.

When Bauer's earliest contributions to economics began to appear in the journals, development economics was not yet recognized as a separate branch of enquiry or study within the economics discipline. His first writings in any case fell outside the boundaries of that branch. As a young scholar, he wrote on such arcane subjects as interest and quasi-rent, and depreciation and interest; he also had published a paper examining notions concerning monopoly; and an early postwar publication was on Lord Beveridge's plan for full employment. In the first half of the 1940s he wrote several articles on the operations and effects of the British agricultural marketing schemes. These studies are still essential reading for any serious

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student of the subject of so-called controlled agricultural marketing, whether in its specifically British manifestations and context, or more generally.

The early works make two things clear. First, they show that Bauer combines a mastery of economic analysis with a consummate ability to apply it to observed situations and processes. Second, it reveals his remarkable ability to involve himself in, and to assimilate the details of, any situation or process he chooses to study, and to place these accurately within their antecedents and their general context.

It was largely by accident that Bauer's interests turned, after the war, to what came to be called development economics, and in which he came to make his major and formidable contributions to scholarship. It is worth saying in passing, though, that he might as readily have applied his gifts to other branches of economics, such as, say, industrial organization and labor economics. In fact, his work in development economics frequently spreads into and illuminates other branches as well.

By means of a detailed study of the degree of concentration in various categories of imports and exports in West Africa he examined the relationship between product variety and market structure, notably the much higher degree of concentration in standardized products compared with more differentiated ones. He has examined in depth the effects of minimum wage legislation, drawing on his extensive knowledge of many Third World countries. I believe he was the first economist to recognize the extent and economic significance of what has come to be known as the informal sector. He demonstrated the scale and significance of the rubber-producing smallholdings of Southeast Asia and the rationale of some of the methods of their operation which before his work were overlooked or misinterpreted.

Bauer's first steps—or, better, his first major strides—toward and into development economics were taken during World War II. He had worked in a London firm prominent in the Malayan rubber industry. He then used a research fellowship to study that industry, and at the same time was commissioned by the British Colonial Office to prepare a report on rubber smallholdings in Malaya (now Malaysia). The resulting works, *The Rubber Industry* (1948) and *Report on a Visit to the Rubber-Growing Smallholdings of Malaya* (1948), established Bauer's reputation as a scholar. The scholarly qualities I noted earlier are seen to flourish in these works. They are enlivened with detailed observation; complex materials are analyzed and synthesized with expertise and acuteness. A leading novelist, the late J. G. Farrell, acknowledged Bauer's works on the rubber industry as having been most valuable to him in his "attempt to recreate the Far

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East of forty years ago" in his novel *The Singapore Grip* of 1978. This is a remarkable compliment to be paid by a novelist to an economist, and reflects Bauer's ability to observe closely and to make significant patterns out of his observations.

A few years later Bauer was again commissioned by the Colonial Office, this time to study trading activities in West Africa with special reference to monopolistic tendencies. Bauer worked on this study for several years, part of the time in West Africa. The result was a massive study entitled *West African Trade,* published in 1954. I know that Bauer thinks this a far better book than his book on the rubber industry. It is certainly unusual in its range, depth, and sustained analysis. Scholars on both sides of the Atlantic have written that it sets standards of writing on the organization and operation of the trading system in LDCs and related subjects by which other works will have to be judged. Its scope extended well beyond the examination of monopolistic tendencies in private trade in West Africa. Thus, for example, he explored the responsiveness of peasant producers to price signals. He explained the role of the multiplicity of traders in economizing resources, encouraging production and promoting economic advance.

In this area Bauer has influenced a number of studies, both by anthropologists and by economists. He demonstrated the analytical and empirical shortcomings of the previously widely accepted proposition, associated primarily with Colin Clark and A. G. B. Fisher, about the relationship between economic advance and occupational distribution. His work includes informative analysis of the rationale of trading methods in West Africa and other less developed areas, the factors influencing the extent of competition in trade, the role of trade in emergence from subsistence production and the significance of the distinction between intermediate and final products in the service sector.

Bauer also studied and analyzed the origins and operation of the state export monopolies in Africa, sometimes termed the marketing boards system. In a number of LDCs statutory bodies were established in the 1940s with the sole right to buy agricultural produce for export. Bauer's meticulous enquiry into the history of the events leading up to the establishment of the monopolistic boards and into their operations is a model of applied economics. His study, fastidiously documented and relentlessly argued, attracted much attention, and provoked a long debate. It was the first of several debates, two or three conducted in print, in which Bauer was the central figure. As regards the marketing boards debate, two points should be made. First, Bauer's analysis of the damaging effects of the Board's price

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policies and activities on production and exports (and hence economic advance) has been borne out fully by events.

Second, the West African experience (and to a lesser extent the earlier Malayan experience) launched Bauer on his studies of the economics and politics of price and income stabilization for primary producers. In this work he laid bare the conceptual confusions underlying much of the professional and political discussions of stabilization. He also analyzed the inherent difficulties confronting any stabilization authority or agency, and put forward the case for the use of some formula that would bind the hands of the authority so that its pricing decisions should not lose contact with market price levels and trends.

The West African trade study heightened Bauer's awareness of the politicization of economic life in many Third World countries. This feature of life in much of the Third World has remained a central concern of Bauer's, and gives a particular cogency and realism, as well as a distinctive flavor, to his work in development economics. He is surely correct in emphasizing that extensive government interventions and controls are rarely designed to achieve some improvement in "economic welfare" in line with some precept or other of pure economic theory. And he is surely correct also in emphasizing the various different ways in which the politicization of economic life undermines the economic endeavors of the people and inhibits economic advance.

A number of Bauer's findings successfully refuted widely accepted views, including academic opinion, and went counter to important political, intellectual, emotional and commercial interests. His findings were at times the subject of sustained debate, for instance in the pages of the *Economic Journal* and elsewhere, from which his opponents usually had to retire, hurt. One example must suffice. His book, *Dissent on Development,* was heavily criticized in a review article whose author acknowledged help of some 15 named individuals, mostly prominent academics. In his reply, requested by the editor of the journal, Bauer was able to meet each point of criticism—in its way it is a *tour de force* that has impressed several scholars otherwise unsympathetic to Bauer's general position and approach.

Bauer's work on Malaya and West Africa, on which he spent about 10 intensive years, drew him toward and into the burgeoning general subject of development economics. His observations and reflections convinced him that much of what was being written and taught about development was seriously misconceived and at variance with the facts. He embarked on a more systematic and sustained study of the economics of poor countries, uniquely founded on his firsthand

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knowledge of two major territories, one in Asia and the other in Africa. He wrote (or in some cases coauthored) a series of articles that reviewed major publications in development economics: these included review articles on three reports (respectively a United Nations report, and the reports associated with the names of Lester Pearson and Willie Brandt) and on major books by Arthur Lewis, Benjamin Higgins, W. W. Rostow, Gunnar Myrdal, and John Hicks. These articles are notable contributions in that they scrutinized publications which either provided syntheses of prevailing influential views and policy prescriptions or presented *inter alia*, new approaches or ideas propounded by prominent academic economists.

In these papers Bauer was quick to acknowledge any useful new insights or thought-provoking ideas. Their main thrust, however, was to confront what he read with what he had seen and studied in various Third World countries, and to consider new ideas and propositions in the light of economic analysis applied with rigor and precision. He generally found little reason to be impressed by new analytical approaches in development economics or new prescriptions for solving the supposed problems of the developing countries—whether these innovations related, for instance, to the unlimited supply of unskilled labor in poor countries, or to the stages of growth through which a country had to proceed, or to the imperative need for the government of a poor country to "mobilize" its resources and plan and direct their use.

Taking his work as a whole, Bauer has successfully refuted a number of the central propositions of orthodox or mainstream development economics. The propositions include the following: that the poverty of poor countries imposes constraints that perpetuate that poverty; that the interests of Third World countries are damaged by commercial contacts with the West; that the terms of trade persistently worsen for Third World countries; that economic advance in the Third World cannot proceed without extensive government planning and control; that population growth and population pressure are major obstacles to progress and prosperity in less developed countries; that the emergence from poverty of Third World countries entails balance of payments difficulties; and that foreign aid is indispensable for Third World development. Bauer's achievement has been to challenge successfully influential mainstream propositions—from which important policy prescriptions are still being derived—by the scholarly methods of careful observation, the rigorous application of economic analysis, and reference to economic history.

Professor Amartya Sen, who certainly does not share Bauer's political position, described him in the *New York Review of Books*

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(4 March 1982, p. 3) as "... one of the most distinguished development economists in the world, and undoubtedly the foremost conservative one." In that article Sen described one of Bauer's essays, "The Population Explosion: Myths and Realities," as "probably the most perceptive and clear-headed analysis of this confusing problem that can be found in the literature" (p. 6).

Bauer has deviated greatly from the mainstream in his insistence on the crucial importance of cultural and political factors in economic development. He emphasizes the significance for economic advance of the attributes, attitudes, and mores of people and groups. He had observed their importance in his own firsthand studies of the multiethnic societies of Malaya and West Africa, and he knows his economic history. Bauer has shown that these factors are much more important than those which usually are singled out by development economists, such as the volume of (monetary) investment, the supply of education, or the presence of natural resources. The neglect of the personal, cultural, and social factors is especially surprising when, in recent years, social arrangements and personal attitudes and motivations have come to be considered to explain differences in economic performance among *advanced* economies.

Bauer has also analyzed the interaction between the conventional variables of economics (and especially of mainstream development economics) with other factors disregarded or treated as parameters in the literature. Some of his writings in this area are rigorous and informative, as for instance his work on the economics and politics of price control in the absence of effective rationing at the retail level.

Bauer has been criticized for not presenting a theory of development in the sense of an overarching theory or explanation of material progress. I think he met this criticism head on, most effectively, in his review article of Sir John Hicks's *A Theory of Economic History*. A theory of economic development is tantamount to a theory of history, and this, Bauer has reminded us, is a will-o'-the-wisp, however seductive. Hicks found Bauer's rather critical review article of sufficient interest that he had it included as an appendix in the Spanish edition of his book. I think you will agree that this reflects much credit on both Hicks and Bauer.

In recent years his prominence as a systematic critic of foreign aid has diverted attention from his other contributions. He is much the most prominent academic critic of this policy. But in this area also he is much more of a scholar than a polemicist. He argues rigorously, and has made several major distinctive contributions. Among his many insights is the recognition that the policy of foreign aid and the concept of the underdeveloped world are inseparable. Without for-

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eign aid there would be no such aggregate as the undeveloped world, less developed world, nonaligned world, developing world, Third World, or South. He has established that foreign aid is the only common bond or characteristic of these collectivities. Before foreign aid one did not lump together Asia, Africa, and Latin America (three-quarters of mankind) into one aggregate. This is a major insight. Moreover, he was probably the first to point out that it was worldwide interest in foreign aid that gave rise to modern development economics, which did not exist as an academic subject or even as an expression before World War II. There is therefore a causal connection between foreign aid and the large number of academic departments, institutions, and centers of development economics throughout the world.

I have tried to review the nature and scope of Peter Bauer's weighty and extensive contributions to the understanding of the economics of poor or less developed countries and regions and of their economic growth or decline. I must remind you, however, that he is not simply a specialist development economist. In recent years he has written enlightening papers on such diverse subjects as the postwar dollar problem, the economics and politics of income inequality (what he refers to, neutrally, as income differences), and class in Britain.

In a report on *Dissent and Development* (from which I have been authorized to quote on an appropriate occasion) Harry Johnson described the book as "a monumental book of great scholarly distinction. . . . It contains a level of broad scholarship, understanding of methodology, and respect for facts that shows up almost all the development economists, and especially the most popular ones. . . ." The works of Peter Bauer written since 1971 would not have caused Johnson to have modified his assessment. Bauer's contributions to economics have been recognized in his inclusion among the small band of "pioneers of development economics" recently honored by the World Bank, in his election to a fellowship of the British Academy, and now in this splendid Festschrift. The distinction of his contributions has been recognized recently also by the conferment of the degree of Sc.D by Cambridge University, the highest doctorate there other than an honorary degree.

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The Disregard of Reality

Peter Bauer

High Hopes and Emerging Doubts

According to Hegel, the Owl of Minerva spreads its wings only at dusk. The later stages of one's career should be propitious for discerning tendencies and forces at work in society. Earlier preoccupations with specific studies can be helpful for subsequent reflection on wider issues but meanwhile absorb time and attention.

Like many of my contemporaries, fellow undergraduates and young academics alike, in my early days I expected much from economics, both in public policy and in intellectual interest. The great advances in the subject and the high intelligence of my academic colleagues seemed to confirm these hopes. Nevertheless, from about the early 1950s increasing claims for economics by its practitioners ran parallel with my own increasing doubts and reservations.

I came to realize for instance that economists systematically exaggerate the impact of their ideas. In an oft-quoted passage in *The General Theory*, Keynes insisted that in the long run the world is governed by little else than the ideas of economists and political philosophers. If this were true, the world would have enjoyed the benefits of free trade for at least 100 years. Apart from being obviously unsustainable, Keynes' opinion is also naively parochial in attributing exclusive influence to the ideas of economists and political philosophers. He neglects the impact of the founders and leaders of religious movements, including the Buddha, Christ, Mohammed, and of military commanders such as Alexander the Great, Julius Caesar and Napoleon.

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The ideas of economists do affect the wider scene; like other ideas they have consequences. As Milton Friedman has reminded us, economists can suggest possible options to politicians. But we must not delude ourselves by overstating our influence, whether in the short period or over the longer run.

Well before my retirement I came to be increasingly perplexed by what was going on in economics. I observed, in particular, a widespread disregard of evident reality, in which I include neglect of basic propositions of the subject. Impressive advances coexisted with alarming retrogression.

Unexpected Transgressions

It was in the 1950s that I first noticed the disregard of reality in economics. It was notable in two contexts: the dollar problem, and the vicious circle of poverty.

For well over a decade in the 1940s and 1950s economists wrote about an indefinitely persistent and inescapable worldwide shortage of dollars. Some of these contributions and predictions were ostensibly sophisticated. In fact, they systematically ignored the rate of exchange, that is, the price of the dollar, as well as major determinants of this price such as interest rates and financial policy. This neglect of basics soon met the fate it deserved. In the later 1950s the shortage of dollars vanished and, indeed, was replaced by a glut. Many leading economists, and not just some amateurs and novices, had overlooked that supply of and demand for dollars depend on price.[1] This particular discussion subsided with the end of the dollar shortage. But its method of approach soon resurfaced in the idea, which is still with us, that poor countries face inescapable balance of payments difficulties.

The theory of the indefinite dollar shortage was not an example of tentative steps in the construction of exciting, and potentially fruitful, theorems or analytical instruments. Nor did the ostensibly elaborate analyses hinge on novel assumptions about expectations or dynamic processes. Rather, the episode was nothing but a serious transgression.

I now come to the vicious circle of poverty. According to this notion, stagnation and poverty are necessarily self-perpetuating: poor people generally and poor countries or societies in particular are trapped in their poverty, and cannot generate sufficient savings to escape from the trap. This notion became a cornerstone of mainstream development economics. It was the signature tune of the

[1]Or more precisely, quantities supplied and demanded.

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advocates of foreign aid throughout the 1950s. It is still often invoked. Yet it is in obvious conflict with simple reality. Throughout history innumerable individuals, families, groups, societies, and countries—both in the West and the Third World—have moved from poverty to prosperity without external donations. All developed countries began as underdeveloped. If the notion of the vicious circle were valid, mankind would still be in the Stone Age at best.

These episodes also alerted me to the role of intellectual and political fashion in much of economics. Prominent, distinguished practitioners seem often to find it difficult to resist the vagaries and winds of fashion, even when these are ephemeral or blow them off course.

I have recently reread part of the literature of these two subjects with a mixture of incredulity, embarrassment and amusement. It looked as if the queen of the social sciences was being dethroned by her entourage.

The two examples I have taken represent unequivocal examples of intellectual retrogression made possible by the disregard of reality. In the interwar years the role of the rate of exchange in the supply of and demand for currencies was routinely recognized. And before World War II, no one would have suggested that poor societies or countries were doomed to stagnation. Historians, anthropologists, administrators, and economists then discussed in detail the impact and implications of rapid changes in less developed countries (LDCs).

Alongside these instances of evident retrogression there took place major advances in economics, including advances in international trade theory and the theory of foreign exchanges, both closely related to the lapses.

There were dissenters from the most widely articulated opinion. This was particularly so in the case of the dollar problem, but applied also to the vicious circle. Some of the dissenters had high academic credentials, yet their views did not have much impact in academic circles and did not reach a wider public. This was because on the contemporary scene, also in academe, a voice is rarely effective without an echo. Dissenters find this difficult to secure unless their dissent is modish. The exponents of the dollar problem and the vicious circle of poverty, especially the latter, were supported and encouraged by articulate groups in the academies and the media. Dissent was crowded out.

These two episodes first prepared me to question received opinion, even when endorsed by the great and the good. Since the 1950s there has been an overdose of examples where reality is simply ignored or brushed aside.

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Let me take a further example. Since World War II, many academics (as well as clerics, public figures, politicians and spokesmen of the official international organizations) have argued that commercial contacts between the West and LDCs inflict economic damage on the peoples of the Third World. Sometimes it is said that Third World poverty is the result of Western neglect; but more often it is claimed that poverty results from Western oppression, exploitation, and manipulation of international trade. These widely canvassed opinions are not confined to Marxist-Leninists. (One should really say Leninists, since Marx was at times lyrical about the achievements of capitalism in transforming backward societies.) Yet as is abundantly evident throughout the Third World the poorest and most backward societies and areas are those which have fewest commercial contacts with the West, and the most advanced are those with the most extensive and diversified contacts, including contacts with those bogeymen, the Western multinationals. Throughout the Third World the level of economic attainment declines as one moves away from regions with most Western contacts, to the aborigines and pygmies at the other end of the spectrum.

Those interested in the survival of ideas may like to know that the notions of the vicious circle of poverty and of the malign economic effects of commercial contacts with the West are alive and well.

Advances in Economics

Over the period in which I have been active in academic economics I have seen remarkable advances and also, as I have just noted, lapses which amount to blatant retrogression.

Advances in knowledge are what is expected from an academic discipline, especially when it has enjoyed a large expansion of resources and of opportunities. Even a necessarily incomplete list of significant advances must include various contributions to price theory, including the recognition of transaction costs; to the role and nature of the firm, including the economics of vertical integration; to the concept and implications of social cost; to the theory of international trade and the theory of the foreign exchanges; to the analysis of the diffusion and use of knowledge; to the economics of property rights; and to the economics of political and bureaucratic processes. Some of these advances have been helpful far outside economics and have been useful to historians, anthropologists, political scientists, and demographers.

Such advances go a long way to support the sanguine expectations of my early days. So do the intellectual capacity and technical com-

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petence of so many practitioners. My academic colleagues in recent years have been no less bright and competent than were most of my teachers a generation ago. If I am now perplexed, it is because I have encountered a plethora of instances of retrogression stemming from the disregard of reality.

The retrogressions are of a quite different order from what went on in economics in the past. The writings of 19th-century and early 20th-century economists were often unsophisticated, even naive. But they were not in such evident conflict with reality as is so much of the more recent literature.

The Emperor Inverted

Mathematization of the subject has perhaps been the most conspicuous thread running through economics since I first entered it. In the 1930s one could read the journals without much knowledge of mathematics, with the exception only of *Econometrica* and the *Review of Economic Studies*. Today one is regarded as unqualified without some knowledge of mathematics, and especially of its language. As economics deals very largely with functional relationships and dynamic processes, some understanding of mathematics is undoubtedly valuable in many contexts ranging from the proper understanding of the concept of elasticity to the appreciation of feedback effects. And it is often convenient to express in mathematical form, inferences and conclusions derived from reasoning and empirical evidence. The appropriate procedure is, however, to reason to mathematics, rather than from mathematics. But as highly qualified practitioners have argued, mathematical methods and formulations have run riot in economics without proper appreciation of their limitations. The major limitations have been pointed out by outstanding scholars with technical mathematical credentials, including Marshall, Pigou, Keynes, Leontief, Stigler, and their observations have often been pointed, specific, and pertinent. Those of Norbert Wiener, one of the great figures of modern mathematics, were particularly vigorous. In one of my books I have referred at some length to his *God and Golem, Inc.*, published posthumously in 1964.[2] Yet these critical observations have made little impact. Reading the journals one gets the impression that economics has become little more than a branch of applied mathematics and one that can be successfully pursued with little reference to real life phenomena.

Another conspicuous development in economics since I first studied the subject has been the use of econometric methods. Much

[2]See Bauer (1981, pp. 263–64), citing Wiener (1964).

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useful work has been done with these methods. But far better qualified people than myself have demonstrated their frequent abuse, and the misapplication or misinterpretation of their results.

Here I want to draw attention only to some of the ways in which mathematical economics and the use of econometrics have contributed to the disregard or neglect of evident reality. Their use has led to unwarranted concentration in economics on variables tractable to formal analysis. As a corollary, it has led to the neglect of influences which, even when highly pertinent, are not amenable to such treatment. Similarly, it has encouraged confusion between the significant, on the one hand, and the quantifiable (often only spuriously quantifiable) on the other. It has contributed to the neglect of background conditions and historical processes where they are indispensable for understanding. For instance, differences in income and wealth, both domestic and international, cannot be considered helpfully without attention to their antecedents and background.

Belief in the well-nigh universal applicability of testing by econometric methods has led to inappropriate claims for these methods. It has also smothered other forms of reasoning and inference. What has become of the traditional method of direct observation, reflection, tracing of connections, reaching tentative conclusions and referring these back to observation and to established propositions of the discipline, or to findings of cognate disciplines? Such procedures are no less informative than quantitative analysis. For instance, with the traditional approaches the economist was much more likely to be aware of the gap between theoretical concepts and the available information.

The acceptance of quantitative methods as the most respectable procedure has permitted the burgeoning of incompetent or inappropriate econometric studies, including those based on seriously flawed data. Conversely, studies based on direct observation or detailed examination of slices of history are apt to be dismissed as anecdotal, unscholarly or unscientific, even if they are informative. All too often their findings are dismissed as no more than casual empiricism or expressions of opinion. Moreover, in what passes for high-level discourse, insistence on the obvious can be made to sound trivial and therefore not worth saying. In short, preoccupation with mathematical and quantitative methods has brought with it a regrettable atrophy of close observation and simple reflection.

I have just asked the rhetorical question of what has happened in economics to the traditional sequence of observation, reflection, inference, tentative conclusion and reference to established propositions, and to findings of other fields of study. Being rhetorical, the

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question can be answered readily. This type of reasoning and its vocabulary have contracted greatly throughout the subject and have virtually disappeared in large parts of it. And the traditional method has retreated not because it has been proved less informative than the methods that have replaced it. It has retreated because it has been castigated as being less rigorous than its more modish successors, largely because it less resembles the procedures of the natural sciences, especially those of physics.

I think that in the course of this shift of approach pertinent differences between the study of nature, especially physics, and economics have not been sufficiently recognized. Some differences may be only of degree, others are sufficiently pronounced to be more nearly differences in kind.

Natural scientists seek to establish uniformities about phenomena and relationships which are substantially invariant. Some of the phenomena and relationships studied by economists are also largely invariant. Others are not so constant, or at any rate their constant components are embedded in so many others that it is often difficult to discern the presence and extent of uniformities. Again, concepts and distinctions widely used by economists—or even regarded as basic—are imprecise, arbitrary, and shifting, and their real life equivalents difficult to pin down: primary, secondary, and tertiary activity, or manufacturing and service activity; voluntary and involuntary unemployment; developed and underdeveloped countries; final and intermediate goods (a distinction that is critical for the definition of income); and many others. This extensive fuzziness of concepts and categories in economics limits informative use of mathematical methods: in mathematics the concepts and relationships, although completely abstract, are more precise and consistent.

For these various reasons, the methods for discerning uniformities, and their extent and limitations, differ considerably between the natural sciences, on the one hand—especially those like physics and chemistry that have been most successfully mathematicized—and social study, including economics on the other hand.[3] Some parts of economics, most obviously development economics, deal with events and sequences the informative study of which needs to incorporate practices from historical scholarship, such as reliance on primary sources, close observation, sustained reflection, the tracing of connections, and others.

[3]There is a large literature on this controversial subject. Apart from Wiener's short essay already mentioned, I have found particularly helpful the observations of Sir Peter Medawar (Nobel laureate biologist) in *The Art of the Soluble* (1967).

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These remarks on the differences between the study of nature and the study of society are not intended in the least to endorse the view that in economics, or social study generally, objective reasoning is impossible, which is another matter altogether. As I have written on this issue in a number of publications, I shall not develop it here and simply say that objective reasoning is quite as possible in economics as in the natural sciences.[4]

Mathematical methods often provide an effective facade or screen which covers or conceals empty formalism. They can camouflage disregard of basic propositions or simple evidence in models purporting to serve as basis for policy. Statistics, technical jargon, and sophisticated econometric techniques can also serve as a protective screen. But the use of mathematics is particularly effective because of the language barrier it provides. What we see is an inversion of the familiar Hans Andersen story of the Emperor's New Clothes. Here there *are* new clothes, and at times they are *haute couture*. But all too often there is no Emperor within.

The achievements of mathematical economics and of econometric techniques have been secured at a great price. This price is not reflected adequately in the direct resource costs. In the book to which I have referred, Wiener insisted that the adoption of mathematical formulation and econometric methods involves misconceived imitation of the natural sciences; and also that it has enabled economists to remove both themselves and their public from the perception of reality.

The Wider Scene

It is not surprising that indifference to reality is not confined to economics, but is extensive on the wider scene also. This divorce from reality is particularly baffling in view of well-nigh universal literacy in the West and the advances in the transmission of information. It is baffling also in view of the profound advances in science and technology. These latter subjects depend on reasoning which, although necessarily abstract, cannot fly in the face of reality.

Disregard of reality encompasses the refusal to accept the plain evidence of one's senses, neglect of simple connected reasoning, and the inability to recognize simple inconsistencies. What is behind all this?

Attempts to explain people's opinions always involve conjecture. Arguments can be assessed conclusively on the basis of logic or

[4]See, for example, Bauer (1972, ch. 15; 1984, ch. 9).

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evidence. But why people accept or canvass them cannot be determined so confidently. In certain contexts some dominant influences are discernible. Many influences themselves represent a disregard of reality and also promote it; as in so many social situations, the process and the outcome are intertwined, even inseparable.

There are some who argue that there is nothing perplexing about conduct and opinions in evident conflict with reality, since they reflect no more than the promotion of self-interest. In this scheme of things apparently paradoxical and anomalous ideas and modes of conduct emerge from the operation of special interest groups or coalitions, including politicians, public servants, academics, and sections of the electorate. This factor can be significant.

Yet the operation of special interest groups cannot account for some conspicuous anomalies. Thus it can explain neither the hostility to the West in major international organizations nor the supine conduct of the West in them. Some of these organizations existed in embryonic form before World War II: the League of Nations in Geneva and the International Institute of Agriculture in Rome were precursors of today's UN and FAO. But their stances differed radically from what goes on there now. Moreover, the West supports lavishly and treats with deference African rulers who consistently vilify it. Such a stance by the West would have been unthinkable in the 1930s. These rulers have no votes in the West, nor do they advertise much in the media.

Amputation of the Time Perspective

Confusion between advancement of knowledge and promotion of policy undoubtedly contributes to indifference to reality. This influence is certainly important in economics. That this is so is suggested by the profusion of transgressions against reality in those parts of the subject close to policy, such as development economics, the economics of Soviet-type planning, labor economics, the economics of poverty, and the economics of market failure. Some practitioners acknowledge the pursuit of political objectives; they also urge that in any event in social study objective reasoning is impossible. I may mention an experience of mine. On several occasions when my lectures criticized the notion of the vicious circle of poverty, members of the audience said that, whatever the validity of my criticisms, the notion was invaluable in the advocacy of foreign aid.

Much contemporary discourse is also afflicted by ignorance of the past and neglect of the time dimension in cultural and social phenomena. Sir Ernst Gombrich has termed this phenomenon the ampu-

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tation of the time dimension from our culture. It has vitiated discourse in much of contemporary economics including, for example, mainstream development economics and the discussion of domestic and international income differences. In these and other parts of economics we cannot understand the situation we observe unless we know how it has arisen. For instance, the low income compared with the West in many LDCs with substantial exports of cash crops has often been adduced to support the contention that external contacts and the production of cash crops are not effective for economic progress, or indeed inhibit it. In fact, many cash-crop exporting countries have progressed very rapidly over the last century or less. But how can we expect societies which in the late 19th century were still extremely backward, or even barbarous, to reach, within a few decades, the level of societies with many centuries, or even millennia, of economic development behind them? Another example is provided by changes in the distribution of income within a country. A higher degree of inequality may result say from a greater reduction in mortality among the poor (which would represent an improvement in their condition) or from the imposition of a regressive tax regime.

The factors behind the debilitating lack of the time perspective and neglect of evidently pertinent background include the speed of social and technical change and the multiplicity of messages reaching people, often about distant events. Very rapid and discontinuous social and technical change can unnerve and even unhinge people. There is only so much change that people can absorb as individuals, families, or societies. By disrupting sustained observation, these influences inhibit both connected thinking and the poise provided by background and time perspective.

Again, any inclination to equate the methods of natural science with those of the social sciences conduces to the downgrading or neglect of antecedents and processes. Whilst antecedents and processes are largely irrelevant in chemistry and physics, and wholly irrelevant in mathematics, they are critical for the understanding of social phenomena. The signal achievements of natural sciences and the pervasive results of their applications encourage habits of thought in social sciences based on misleading analogies between the two realms of study.

Whatever the factors behind them—and the list proposed here is both tentative and incomplete—lack of knowledge of the past and neglect of the time perspective are evident in much contemporary discourse. The resulting loss of collective memory has also opened the way for the manipulation and rewriting of history.

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Collective Guilt

The widespread or at any rate widely articulated feeling of guilt in the West is a significant influence behind some of the novel and baffling manifestations of the contemporary disregard of reality or even its denial. It helps to explain such matters as the acceptance of unfounded notions about Western responsibility for Third World backwardness and of the allegedly damaging effects of commercial contacts between the West and LDCs; the spineless conduct of the West toward African despots with negligible external power and resources, and the readiness of the West to support them in spite of their hostility to the West and in the face sometimes of inhuman domestic policies; and also the readiness of the West to finance international organizations that serve as forums for the embarrassment and undermining of the West. The guilt feeling in the West is reflected, for example, in the hostility toward South Africa. Whatever one may think of the conduct of the rulers there, they certainly treat their subjects no more harshly than various black rulers. As is well known, many people from black Africa are anxious to migrate to South Africa. The rulers of South Africa are singled out for special obloquy because they are white. Were they any color other than white, their conduct would arouse little or no comment in the West.

Again, the readiness to give aid to Asian and African rulers without questioning their policies reflects the same influence. Guilt-ridden people hope to assuage their feelings simply by giving away money (especially taxpayers' money) without questioning the results: what matters is to give away money, not what results from this process.

Although some elements of guilt feeling are part of the Judaeo-Christian tradition, guilt today is novel. Materially, the West has never had it so good, nor ever felt so bad about it. One reason for this is probably the failure of material prosperity to bring about the contentment and happiness so widely expected from it. Guilt has contributed to the confusion between the merits of charity in helping the less fortunate and the notion that income differences as such are reprehensible results of oppression and exploitation. These differences are commonly referred to as inequalities or even as inequities. The confusion has been encouraged by an eagerness of churchmen to see themselves not as spiritual leaders but as social welfare workers or political activists.

Moreover, many influential opinion formers, including teachers, clerics, and people in the media, have come to dislike Western society, or even to hate it. They are apt both to harbor and to provoke feelings of guilt.

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A major factor behind the emergence of contemporary collective guilt has been presumably the erosion of personal responsibility under the impact of social determinism. Participation in collective guilt has taken the place of individual responsibility. External forces are held responsible both for personal misconduct and personal misfortune. And if we are all guilty, then no individual is.

Guilt feeling in Western societies has promoted indifference to reality, a loss of poise and a loss of confidence. Loss of continuity and the amputation of the time perspective reinforce these effects of collective guilt. Kenneth Clark wrote that he was not sure what were all the necessary ingredients for civilization but he was sure that confidence and continuity were indispensable. Both have been seriously eroded in recent decades.

Misuse of Language

In recent decades many thoughtful people have commented on the misuse of language, both in public discourse and in education. Disregard of reality promotes erosion of language, which promotes further disregard of reality. Language is to a culture or a society what money is to an economy; their erosion leads to a disintegration. Misuse of language covers the shifting interpretation of concepts such as socialism, equality, growth, monopoly, and many others. At times misuse of language is even acknowledged. If a country is officially designated as democratic or as a people's republic, we know that it is one in which people have no say in the government. Another category of examples is the treatment of countries and other collectivities as if they were single decision-making entities, or entities within which all the people have identical interests, experiences, and conditions. The aggregation of two-thirds of mankind as the Third World is a conspicuous example.

The growth of specialization, including long periods of specialized training, inhibits the exercise of critical faculty outside a narrow range and engenders disregard of reality in much academic and public discourse. This disregard is also facilitated by an understandable and rational reluctance of people to exercise their critical faculties in matters which affect them but about which they feel they can do little or nothing.

The vast expansion of information in recent decades may have been critical in the widespread atrophy of reflection. People, including academics, are expected to absorb so much information and technique that all too often they have little time, inclination, and capacity

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left for reflection and observation, even for simple assessment of the information reaching them.

The decline of traditional religious belief may also have conduced to a disregard of reality. This explanation could be appealing both to believers and to skeptics. Traditional religious belief provides a unified coherent world view, the erosion of which enfeebles connected thinking. Conversely, it can be argued that the decline of religious belief diffuses the credulity of mankind over wide and more diverse areas. The speed of the decline reinforces such effects.

In this section and its three predecessors I have suggested some of the forces and influences behind the contemporary disregard of reality. I must remind the reader, however, that such suggestions are necessarily somewhat speculative. This is especially true of reflections on the varied and complex forces behind the Zeitgeist.

Need to Restate the Obvious

What has happened to us in the West for us to be so ready to fly in the face of reality and to reject the evidence of our senses? What makes us lose our poise and self-respect? It is as if amidst unprecedented prosperity and scientific achievement, inexplicable malevolent forces had undermined our mental and moral faculties.

The extensive and baffling indifference to reality matters greatly. Among other results, it has undermined standards in parts of economics, in other social studies, and in wider areas of ostensibly serious discourse. It is reversion to barbarism. Ortega y Gasset wrote that the absence of standards is the essence of barbarism. It is because this condition prevails in parts of economics alongside its great achievements of recent decades that I am now so baffled by the present state of the subject.

The tendency to disregard simple realities has undermined the poise, self-assurance, and stance of the West in the international arena. It has also underpinned the uncritical acceptance of ideas and policies damaging to the West, and much more so to the peoples of the Third World. This is not surprising. Polities and societies bent on disregarding reality must be vulnerable to adversity, and also to threats from within and without.

Such concerns highlight the perceptiveness of two observations by authors widely separated in time and very different in general outlook. Their observations make a fitting conclusion to this essay. Pascal wrote in the 17th century: "Let us labour at trying to think clearly: herein lies the source of moral conduct." (Travaillons donc à penser bien: voilà le principe de la morale.) And in our own time

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George Orwell wrote: "We have sunk to such a depth that the restatement of the obvious has become the first duty of intelligent men."

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Markets, Mandarins, and Mathematicians

Deepak Lal

Introduction

I would like to begin on a personal note, in part to expiate past sins of omission, partly to allow me to illustrate a major theme of this paper.

Though I began the study of economics at Oxford in 1960, to my shame the sole work of Peter Bauer's that I had read until fairly recently was *Indian Economic Policy and Development* (1961). Leafing through my copy of Bauer's book to prepare this paper, I found the margins covered with exclamation marks and "see Little." The latter reference is, of course, to Ian Little's 1961 review of Bauer's book in the *Economic Journal*. Little's opening salvo gives a fair idea of his central thrust (1961, p. 835):

> One would like to discuss this book as the obvious outpouring of a political adolescent with an economic *idée fixe*. But it is meant for laymen who do not know India. They might be misled by the arguments of a professor whose chair has special reference to economic development and underdeveloped countries.

Not wishing to be misled, and impressed by the intellectual authority of our leading mentor, Bauer's work was written off by my contemporaries as that of an economic illiterate and a political adolescent. But when I reread the book, Little's review, and his own subsequent survey of the current status of the economics of development

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(Little 1982), it was apparent that by 1982 Little no longer seemed to subscribe to the views he espoused in 1961.[1]

Clearly, Little (along with many other early critics) would now accept that, particularly on issues concerning the role of markets in development, Bauer's 1961 book and other writings on the Third World were prescient. Yet, professional development economists are still reluctant to give him his due. There is, for example, only one reference to Bauer in Little's 1982 book, and that in a footnote identifying him as one of the many economists in England who became "exclusively development economists" after World War II (p. 35).[2]

While Michael Lipton (1984), in his comments on Bauer's World Bank Pioneers lecture,[3] provides a very perceptive appreciation of Bauer's work, T. N. Srinivasan (1984) in his comments on the same lecture is clearly very uncomfortable in Bauer's company. The reasons he gives for his discomfort are highly revealing. They suggest why the *type* of arguments Bauer uses in support of the market mechanism have not been found persuasive by many professional economists.[4] Srinivasan (1984, p. 59) writes:

[1]One example should suffice to illustrate how Little's views changed between 1961 and 1982. In 1961 Little (p. 837) wrote:

> Economic arguments are, it seems to me, used in a one-sided manner as persuasive devices. First, [Bauer] says that a bad harvest and a rise in import prices cannot cause a substantial deterioration in the balance of payments, on the insignificant grounds that they also reduce incomes: while on the export side he argues that overvaluation of the rupee discourages exports, implicitly discounting the possibility of inelasticity of demand with the remarkable statement that "the volume of Indian exports bears no relation to the total world demand for the products" (p. 64). No wonder he can imply that there never need be any connection between development and balance of payments difficulties.

In this critique Little is clearly basing himself on the two-gap model of which he recognized himself to be a pioneer (see Little 1982, p. 148, and its references to Little 1960). After summarizing the implausible conditions on which this view is based, Little (1982, p. 148) concludes: "Given time to make adjustments, I doubt whether any country has ever been in such a position." As regards Bauer's illiteracy in not recognizing the inelasticity of the demand for Indian exports, Little (1982, p. 139) states "that incentives work is shorthand for saying that export demand and domestic supply are both elastic."

[2]My purpose in exhuming this past is not to castigate Little; in fact these changing views parallel my own. I bring these matters up in part as a mea culpa.

[3]Lipton (1984, p. 45) rightly notes: "Lord Bauer is a *classical* economist. Enterprise, trade, enlargement of markets: these are the engines of development. Bauer makes no neo-classical claim that all businessmen act like profit-maximisers, or would maximise welfare if they did. For Bauer, it is the move from subsistence to ever larger markets that counts."

[4]I, of course, discount the hysteria of those numerous dirigiste development economists who over the years have made Bauer into their bête noire. As Alan Walters rightly notes in his comment on my paper, the primary opposition to Bauer's views in the 1950s and 1960s in the U.K. came from the socialist antimarket followers of Joan

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> While I agree with Lord Bauer that a much greater reliance on markets is called for in many developing countries, I find in his writings more polemics and debating points than depth. A far deeper analysis of the role of markets and development can be found in the few pages of Kenneth Arrow's presidential address to the American Economic Association.

He then goes on to cite the well-known reasons within the Arrow-Debreu framework for market failure. Srinivasan (p. 55) commends

> current research [that] involves investigations into the role of alternative institutional and contractual arrangements that exist in the absence of a complete set of insurance and future markets. . . . A fuller understanding of their systemic role in concrete sociopolitical-economic contexts is essential in devising developmental policies. In the absence of such understanding, a discussion of the place of markets, or, for that matter, central planning cannot go very much beyond assigning totemic value to either. *Further, since governments, just as markets, can be and often are imperfect, and are subject to lobbying, interventions to correct market imperfections that are optimal in theory may turn out to be worse than no interventions at all* [emphasis added].

The italicized passage provides the reasons that make Srinivasan (and me) suspicious of the presumption for dirigisme commonly adduced within the Arrow-Debreu framework. This indirect and, as some would say (see Barry 1985), "limp justification" for the market is based both on the logic of second-best welfare economics as refined in the 1960s within the Arrow-Debreu tradition, as well as from observations of the actual effects of government interventions in many developing countries (reviewed in Little 1982; Lal 1983). Thus, though Srinivasan would, from his sophisticated Arrow-Debreu perspective, reach many of the same practical conclusions as Bauer on most policy-related issues concerning government intervention, he is deeply suspicious of Bauer's style of argument, of his "fulminating against government intervention" (p. 55), because it is not couched in the Arrow-Debreu language. It is differences in rhetoric (in Donald McCloskey's [1983] sense) rather than divergent assessments of the need for government intervention in specific cases in developing countries that set them apart.

Robinson at Cambridge and Thomas Balogh at Oxford. They were not mathematicians. I do not discuss their views in this paper, in part because I have done so elsewhere (see Lal 1983), and partly because I am more concerned in explaining why the mainstream of the profession—which cannot be put into any narrow ideological category, but which was (and is) by and large led by mathematicians—finds Bauer's views so uncongenial.

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The dominance of the rhetoric of mathematicians—particularly their protectionist demarcation of what is to count as rigorous theory—explains Bauer's failure to persuade mainstream professional economists in the 1950s and 1960s, when mathematicians still hoped to provide mandarins with the tools to improve on markets. But even with Bauer's views on the relative efficacy of markets and mandarins, drawn from a different and older rhetorical (but by no means atheoretical) tradition in economics, being vindicated by the development experience of the 1970s and 1980s, there is still much discomfort among mainstream economists in accepting this cuckoo in their nest. This, however, as McCloskey (1983) has cogently argued, is a sign of the impoverishment of the rhetoric of mainstream economics, based as it is on an epistemologically unsound positivist view of economics as a science. By contrast, the popularity of Bauer's work among laymen—much to the fury of the technicians—is partly based on his appeal to an older classical tradition of political economy, whose modern-day representatives can broadly be classified as neo-Austrian.[5]

The two Weltanschauungs lead to different visions of the market process and how its social efficacy is to be judged. These visions are not mutually exclusive, though overconcentration on one at the expense of the other does lead to different degrees of support for the market. One person's ideology becomes another's vision.

The resulting incivility of economic conversations causes confusion in the lay public's mind with respect to economists' support for the market. Thus, in this paper, I want to argue against the intellectual imperialism of both the axiomatic, positivist, Arrow-Debreu paradigm of mathematicians, as well as the "libertarian" aprioristic paradigm of neo-Austrians. For in ongoing debates on public policy the former directly and the latter indirectly (through the sort of religious resistance it evokes among unconverted positivists) provide intellectual or emotional support for mandarins and what I have elsewhere termed the "Dirigiste Dogma" (Lal 1983).[6] Finally, I shall also deal (albeit briefly) with the arguments advanced by those I call the "moral imperialists" against the market.

[5]The term "neo-Austrian" refers not to a particular type of capital theory, but to the general Weltanschauung of Austrian economics, beginning with von Mises and further elaborated by Hayek, Haberler and some members of the Chicago and public choice schools.

[6]I fully accept Alan Walters's point in his comment that mandarins do not need economists to convert them to dirigisme. As David Henderson (1985) has pithily documented, they are natural dirigistes. What concerns me in this paper is the indirect or direct support economists may have provided to their irrational dirigisme.

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The Arrow-Debreu Vision of the Market

Even though mathematicians can find an antidote within their chosen rhetoric for the prima facie dirigiste implications of the Arrow-Debreu framework, with considerations of bureaucratic failure offsetting those of market failure in any real world, and hence necessarily imperfect economy and polity, there are some who are still bewitched by the seeming plausibility of letting mandarins loose (albeit guided by technical experts) in an imperfect economy. They have lent indirect intellectual support to the natural dirigisme of mandarins and the modern-day lay public in their addiction to what David Henderson (1985) has aptly labeled "do-it-yourself economics."

As examples I would like to consider the writings of three former colleagues of Bauer at the London School of Economics, economic theorists of the highest distinction for whom I have the greatest respect, Professors Dasgupta, Hahn, and Sen. In their writings on "the market" (Dasgupta 1980; Hahn 1984; Sen 1983), all three follow the Arrow-Debreu vision of the market process and assert that the justification for the market is provided by the two so-called Fundamental Theorems of Welfare Economics that can be derived within this framework.[7] I do not need to go into the stringent conditions (which, being coterminus with those for perfect competition, require "complete markets" for all goods indexed by physical and locational characteristics, and by temporal states of nature) necessary for the existence of such an ideal state. All three of these distinguished theorists, however, explicitly or implicitly argue that the case for the market depends on asserting that the conditions in any real world

[7]As Dorfman-Samuelson-Solow (1958, pp. 409–10) put it:

> The main propositions of welfare economics are usually stated in terms of a long string of equivalences among marginal rates of substitution in consumption and marginal rates of transformation in production. More recently it has become common to sum up all these in one brief and easily understood theorem which contains everything of significance and provides the backbone of modern welfare economics. This fundamental theorem states: *Every competitive equilibrium is a Pareto-optimum; and every Pareto-optimum is a competitive equilibrium.*

In its more refined version, in order to distinguish between the infinite number of Pareto "optima" that can be competitive equilibria, starting from different initial endowments of the agents, and the optimal allocation among the Pareto-efficient outcomes—which must depend on an ethical evaluation of the alternative distribution of the endowments or outcomes as summarized in some "social welfare function"—it is usual nowadays to distinguish between Pareto-efficient equilibria, which correspond to the "Pareto-optimum" in the above quotation and the full Pareto *optimum* which is that ethically preferred among the infinity of potential Pareto-efficient outcomes within this framework.

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economy correspond to those required for perfect competition.[8] It is child's play to show the implausibility of the reality of the completeness of markets, and therefore of perfect competition. "Hence, economies which significantly depart from perfect competition—that is, in general, actual economies—would be candidates for the deployment of a visible hand" (Hahn 1984, p. 118). Considerations based on the ethically preferred distribution of endowments and incomes, as well as the existence of public goods and externalities, are then adumbrated at length to create the impression that "market failure" is ubiquitous (as it surely is) and that its correction requires massive government intervention (which is arguable). Only at the end and almost in passing is there any mention of the antidote to dirigisme that is to be derived from this framework.[9] As John R. Hicks (1985, p. 6) has rightly noted:

> When the economist has got his "welfare" rules and has established (if he can) that, existing organisation does not satisfy them, he has still not finished his job. For he has no right to criticise the existing organisation simply on account of what, he has so far shown. For anything that is yet apparent it may be that there is no *practicable* organisation which will satisfy wants any "better", which will approach the optimum any more nearly. In order to have a basis for criticism it has to be shown that there is a practicable alternative organisation which can be expected to do this.

Partha Dasgupta (1980, p. 112) does attempt to do this. He rightly notes:

> The operational appeal of the Fundamental Theorem of Welfare Economics is of course minimal. The informational requirements for the state are awesome. It is required to know the preferences, endowments and the (personalised) production set of all individuals. These observations alone suggest that individual rights to certain private decisions may not only be a moral imperative, but may

[8]Hahn (1984, p. 115), after summarizing the fundamental theorems, states: "*They have led many* to claim that the invisible hand is not only smart but also beneficient" (emphasis added). They have led many? Whom? There is not a single citation.

[9]Hahn (1984, p. 120), after expending nearly eight pages on developing the well-known themes of "market failure," makes this central point as a mere qualification to what has gone before:

> Nor is such failure sufficient groun[d]s for intervention, since it remains to be demonstrated that "government failure" is less damaging than market failure. Hence although there may be a prima facie ground for intervention when the invisible hand fails, and no such grounds when it does not, there is some arguing and thinking to be done before a case for intervention has been clinched.

In the rest of Hahn's paper, however, there is none of the further "arguing" required to justify government intervention, which essentially concerns the nature and behavior of "governments" or the "state."

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> at once be a necessity prompted by the fact that the state possesses incomplete information.

He then summarizes the recent mathematical economics literature on "incentive compatibility" and the problems this raises for a command economy run by mandarins, as Hayek and Mises pointed out at the start of the "planning debate" in the 1930s.[10] In this framework the only feasible incentive-compatible resource allocation mechanism is *not* a command economy, but one that achieves a full optimum by working through the price mechanism supplemented by optimal taxes and subsidies.[11]

But implementation of "optimal taxes" raises a host of questions about the character of the mandarins required for their design and administration. To achieve the desired outcomes, the mandarins would have to be "economic eunuchs" (in James Buchanan's apt phrase). Dasgupta (1980, p. 119), to his great credit, recognized this when he wrote:

> It has been an abiding shortcoming of applied welfare economics that it has for the overwhelming part supposed a perfect government—one that faithfully goes about its tasks. But if one addresses oneself to the question of what incentives there must be to ensure that governments undertake their tasks faithfully one is, at a minimum faced with the principal-agent problem with all its attendant difficulties.

Although Dasgupta cites Buchanan's and Hayek's work (in a footnote) as very important exceptions, he does not follow this lead to examine the thinking on "constitutional economics" that the Virginia public choice school has pioneered and which is the next natural stage of the argument. Instead he discusses the complementary viewpoint of Hayek on social organization and his neo-Austrian justification for a market order. But Dasgupta (1980, p. 118) ends by dismissing Hayek's *system* of thought:

> Such an anti-rational view, disagreeable though it may be to many, is still not the most disturbing feature of Professor Hayek's philosophy. Ultimately, it seems to me, what is most disturbing is the degree of authoritarianism that he would appear to be willing to tolerate for the sake of his conception of progress.

Sen takes a similarly jaundiced view of Hayek's defense of a spontaneous market order. This is not the occasion to discuss such com-

[10]See Hayek (1935).

[11]As Dasgupta (1980, p. 114) puts it, "The full optimum can still be implemented in a manner that is compatible with incentives; but decentralisation is a necessity imposed by the question of incentives now—not solely a moral requirement."

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mon misunderstandings of Hayek, which, as John Gray (1984) has recently shown, are based on a lack of understanding of Hayek's epistemology. Instead I want to argue that they illustrate the difficulty faced by even the most sophisticated mathematical economists in comprehending this alternative vision of markets.

Neo-Austrian v. Neo-Classical Views of Government

The neo-classical recognition of the importance of imperfect information and pervasive uncertainty in economic life has been accompanied by the realization that general equilibrium theory with its Walrasian auctioneer only considers "situations in which the invisible hand has already accomplished its task" (Hahn 1984, p. 125). Echoing the Austrians, the market process is seen as a disequilibrium system moving toward the notional Walrasian equilibrium through a sequence of temporary equilibria. At each moment in time, economic agents are Bayesian econometricians updating their probabilistic forecasts of future prices on the basis of currently observed values of the relevant variables.

However, this is a vision of the market process as a mechanical system moving through an environment of Knightian risk. It takes no account of the irreducible Knightian uncertainty (or ignorance) in economic life, which is an essential ingredient of both the Austrian view and, it should be said, Keynes. As Stephen Littlechild (1986, p. 28) has observed: "The crucial feature of the neo-classical approach is that *the form that the future can take is known in advance*. . . . The neo-classical agent lives in a world of Knightian risk."[12] By contrast, Littlechild (pp. 28–29) sees the Austrian view (represented by Kirzner 1973) as an approach whereby

> the agent may be characterized as knowing some things and not knowing others. The problem is not uncertainty (or risk) but ignorance. Over time, however, the agent discovers things of which he or she was previously unaware. The Austrian model differs from the neo-classical model with point estimates in two respects. First, the revision of forecasts is not merely an updating in the light of experience—it may take place autonomously, as when, for example,

[12]Also see Lal (1982, 1985) about the importance of the distinction between Knightian risk and uncertainty, which mathematicians and economists had tended to ignore on the grounds that genuine uncertainty cannot be modeled. But see the important paper by Heiner (1983), which argues that the predictable behavior that economists are concerned with can exist only as behavioral rules for an environment that is irreducibly uncertain. "[O]bserved regularities of behavior can be fruitfully understood as 'behavioral rules' that arise because of uncertainty in distinguishing preferred from less-preferred behavior. . . . It is in the limits of maximizing that we will find the origin of predictable behavior" (p. 561).

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> the agent discovers a hitherto unsuspected source of supply. Second, this new opportunity is not necessarily a better value for a known variable—it may be a completely new variable. For example, a consumer may discover honey for the first time. Risk (and uncertainty) are not the essence of the Austrian approach (a la Kirzner). Tomorrow is a vector of which the agent knows some components but not others; he or she knows there will be other components, but not what they will be; consequently, the agent cannot form a probability judgment as to the likelihood of their occurring.

The entrepreneur who is at the center of Kirzner's Austrian theory is the agent who moves the real "disequilibrium" world through arbitrage toward the notional competitive equilibrium. He is to be contrasted with the Schumpeterian entrepreneur who, through his innovation and "animal spirits," is a *destabilizer* of a notional Walrasian equilibrium. Mathematicians have attempted to model Schumpeterian innovations, but apart from one effort by Littlechild and Owen (1980) there has been no attempt to provide a formal account of Kirzner's entrepreneur. This lack of formalism and its reluctance to rely on positivist methodology are considered to be shortcomings of the Austrian approach, as noted, for instance, in Benjamin Klein's (1975) review of Kirzner's (1973) book.

But even among Austrian converts, as Littlechild (1986, pp. 32–33) notes, there are critics who question Kirzner's assertion that the market process "tends to coordinate rather than discoordinate":[13]

> Kirzner's view is that entrepreneurship consists in the discovery of opportunities thrown up by exogenous changes but not yet noticed by other market participants. In this sense, the entrepreneurial market process is one of continual discovery and increased coordination. Critics point out that this analysis downplays (or even ignores) the possibility of mistakes. . . . It is true that market participants are trying to foresee the future correctly, and that market forces will *tend* to eliminate the unsuccessful participants; but they cannot guarantee that every entrepreneurial action (or even most such actions) will increase coordination in the market.

The essential difference between the neo-Austrian and neo-classical viewpoints concerning the proper role of government in an

[13]Hahn (1984, p. 127) makes much the same point. "Opportunities for mutually advantageous trade must be recognised and hence signalled . . . trade opportunities are supposed to be signalled by prices which are public and anonymous—they do not depend upon the persons engaged in the trade. . . . In such a world, it is false to propose that, because there are unexploited gains from trade, it will always be rational to signal this by price changes. The manner in which potential traders can communicate is of basic significance. One should have thought that, in an age where the prisoner's dilemma . . . is known far and wide, this point hardly needed making."

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economy must therefore lie elsewhere. It seems to me to be analogous to the differences between those who hold to procedural- or "entitlement"-based views of justice (for example, Robert Nozick) as compared with consequentialist views (for example, utilitarians). Thus Buchanan (1986, p. 22) states: "How does one improve a market? One does so by facilitating the exchange process, by reorganizing the rules of trade, contract or agreement. One does not "improve" or "reform" a market-like exchange process by an arbitrary rearrangement of final outcomes."

As one who shares the pluralist vision of society of the great Oxford liberal philosophers Isiah Berlin and H. L. A. Hart, I have found recent discussions in ethics based on a desire to find some absolute ethical standard, to judge social orders conceived as a choice between "rights" and "utility" particularly uncongenial.[14] Similarly, I find the desire to limit discussions of potential interventions to improve market efficiency purely to the derivation of appropriate procedural rules through a constitutional specification of efficient property rights as being too narrow. An example will make my position clear.

As is well known, the Coase theorem concerning externalities shows that voluntary exchanges within an appropriately defined and legally enforced system of property rights will be able to ensure allocative efficiency in the Paretian sense. But as Cootter (1982) noted, this result depends on the assumption of nonstrategic behavior on the part of agents. According to Buchanan (1986, p. 93): "In the absence of some externally imposed rule for dividing the purely distributional gains, there is no assurance that exchanges in rights will shift the economy toward the Pareto efficiency frontier and maintain a position on the frontier once reached."

Buchanan resolves this dilemma (within the neo-Austrian framework) by distinguishing between the ex ante and ex post aspects of choice.[15] He insists that, as only the ex ante aspect of choice is relevant from a full-blooded subjectivist Austrian perspective, revealed preference is sufficient to ensure that voluntary exchanges within a Coasean system of property rights will achieve efficiency, in the sense that resources will necessarily move to their highest valued uses. In this purely subjectivist view, no objectively measurable harms and benefits can be derived (even conceptually) from the ex post results of choice, and which could be used by an external observer

[14]Buchanan (1986, p. 51) would be in the same camp. I do not think, however, that Sen's (1985) attempt to marry the two views in his so-called capabilities approach is successful.

[15]See Buchanan (1969).

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to determine a unique Pareto-efficient outcome. Only the initial assignment of property rights can be questioned.[16] Moreover, only the rules derived from a community-wide consensus for the designation of these property rights, argues Buchanan, will be efficient.[17]

Even if the logical validity of this full-blooded subjectivist-contractarian view is granted, it still seems to me to make no allowance for the contingent factors of history. As a descriptive theory of the evolution of modern states, it is obvious that apart from the United States and, paradoxically, modern India, most modern states did not emerge from the deliberations of constituent assemblies. The logrolling, vote-trading equilibria that the theory depends on are irrelevant for most Third World countries—which are not democracies.[18] Moreover, on purely practical grounds I find it well beyond the bounds of the "suspension of disbelief" that, in the myriad countries of the

[16]Thus Buchanan (1986, pp. 94-95) states:

> If the only source of valuation of assets or resource claims is the revealed choice behavior of parties to potential exchanges, there is no means through which an external observer can determine whether or not trade, as observed, stops short of some idealized norms. If a person A is observed to refuse an offer of $x for asset T, then person A must be presumed to place a value on T in excess of $x. That asset, in A's usage, must be yielding a value or benefit more than $x. The fact that, some portion of the imputed subjective value of T, to the current owner, A, may be based on his estimates as to the real preferences (valuations) of B, the potential purchaser, is totally irrelevant. . . . ("Efficiency") in resource use, *given the institutional setting*, is ensured so long as A and B remain free to make the exchange or to refuse to make it. [But he goes on to note that with the Coase theorem] so interpreted, the theory becomes a tautology. . . . In this construction how can inefficiency possibly emerge? [He argues, however,] that agreement is the only ultimate test for efficiency, but that the test need not be confined in application to the allocative results or outcomes generated under exploiting existing or defined institutional-structural rules. . . . Agreement on a change in the rules within which exchanges are allowed to take place would be a signal that patterns of outcomes reached or predicted under the previously existing set of rules are less preferred or valued than the patterns expected to be and generated under the rule as changed. Hence, the new rule is deemed more efficient than the old.

[17]It should be noted that the "unanimity rule" does not require unanimity of values or views; as in the vote-trading equilibrium that Buchanan and Tullock (1962) envisage, logrolling could still lead to unanimous decisions. The main argument against the procedure is that it ignores the "consequentialism" that many find appealing (see Sen 1970, pp. 24-26).

[18]There is also de Jasy's (1985, p. 65) criticism that these contractarian theories remain instrumentalist and like other theories of the benign state "carry the tacit assumption that the satisfaction or happiness of the state is for some reason and in some manner attained through the happiness of its subjects. No good reason is offered for this, nor a plausible manner in which it could take place." As regards the faith of those "constitutionalists" who believe that Leviathan can be chained to the mast through constitutional rules, de Jasy is surely right that, "with its key always within reach, a chastity belt, will at best occasion delay before nature takes its course" (p. 187).

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world, the unanimous decisions of a constituent assembly continually discussing matters of entitlements and property rights is a *feasible* method of dealing with the "market failure" admitted to potentially arise from externalities and strategic behavior—even within the neo-Austrian perspective. As Buchanan (1979) himself notes:

> It seems to me that one of the dangers of the subjectivist approach, and particularly in its pure Austrian variant, is the tendency to form a priesthood, with the converted talking only to those who are converts. . . . Milton Friedman . . . objects to the Austrian-subjectivist approach largely on the grounds that it implies conversion rather than gradual conviction by the weight of logical argument and empirical tests [pp. 83–84, 90].
>
> An understanding and appreciation of the principle of spontaneous order or coordination may emerge from the very citadels of objectivism, and often does. After all, Adam Smith was no subjectivist. What I am implying is that to the extent that subjectivism tends to concentrate attention on the interaction among persons and away from the "economic problem," an understanding of the principle of order is facilitated rather than retarded. The post-Robbins maximizer must learn the principle of order in spite of rather than because of his analytical paradigm [p. 84].

With this last statement I can agree. As such I remain an agnostic in these tussles between the alternative grand visions (objectivist-subjectivist) of markets and how they can be improved. As Deng Xiaoping is reported to have said: "It does not matter whether a cat is black or white, the important thing is, does it catch mice."[19]

Ethical Justification of the Market

All three of our representative "mathematicians," however, raise one thorny issue concerning the ethical justification of the market that can be illumined by the Austrian vision of the market as a process, and by the constitutional perspective of the public choice school. This is a large subject that I cannot discuss with any thoroughness in this paper (but see Sen 1985; Buchanan 1986; Gray 1984; and Brittain 1986).

Ethical criticisms of the system of voluntary exchanges that constitute the market process can be considered misguided for a very simple reason. The market process itself translates the initial endow-

[19]This position can of course slide into a form of utilitarianism that is open to de Jasy's (1985, p. 88) charge: "Judging things on their merits with an open mind fatefully attracts open minds." But as I argue later, we do not need to commit ourselves to any particular set of theoretical or ethical beliefs to form a practical judgment about the need for economic liberalization in the Third World.

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ments of agents into final outcomes. Ultimately, it is the ethical justification of the initial distribution of endowments that is usually in question—as is recognized by traditional welfare economists (using the so-called converse theorem and distinguishing between Pareto-efficiency and Pareto-optimality), by Marxists (whose notion of exploitation emphasizes the distribution of the ownership of the means of production, recently extended to include human capital [see Roemer 1983]), as well as by the Austrians and other procedural (rights-based) moral theorists (e.g., Nozick). The voluntary market exchange process for transforming these endowments into market outcomes can hardly be called moral or immoral.

In this context it is particularly surprising that Sen (1983) should argue, against the procedural theorists of justice,[20] that the existence of disasters such as famines is an argument against the market process, particularly when he himself states that he has "presented evidence to indicate that many famines—even very big ones—have taken place in the recent past with no overall decline of food availability, and millions have died because of being deprived of food in terms of market command, *reflecting sharp failures of entitlement*" (Sen 1983, p. 12, emphasis added). But if it is "failures of entitlement" that lead to the awful outcomes, why should the process of voluntary exchanges be blamed?[21]

The real argument against a property-rights-based, converse theorem of welfare economics depends, as Sen (1983, 1985) recognized, on adopting the "imperfect information" insights of the neo-Austrians. Sen (1985, p.12) argued: "If the *information* regarding individuals is inadequate for determining what the initial distribution should be, *or* if there is an absence of—or reluctance to use—a political mechanism that would *actually* redistribute resource-ownership and endowments appropriately, then the practical relevance of the converse theorem is severely limited." As a second-best solution, it may only be feasible to achieve an ethically preferred distribution of endowments through interferences with market outcomes, with the gains in equity being set against any losses in efficiency that may result.

[20]Such as Nozick, who has argued that once an initially just distribution of endowments has been created—a tall order as we shall see below—there is no moral justification for altering the outcomes resulting from "capitalist acts among consenting adults" (Nozick 1974, p.173).

[21]The Indian famine code introduced by the British in the late 19th century explicitly recognized that famines were a result of a loss of entitlements, and instructed district authorities to transfer purchasing power to the poor once a state of famine was declared in the district.

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The argument against the "moral imperialist" view—if I may so label it—depends on the assumption of a universal moral code that allows some observing economist to make value judgments encompassing both the efficiency and equity components of economic welfare. But casual empiricism is enough to show that there is no such world society; nor is there a common view, shared by mankind, about the content of social justice.

Against Sen's assertion that egalitarianism is a universal value, because "indifference to the *inequality of well-being* requires some justification,"[22] one can only say that, as witnessed by numerous societies both past and present, the value of the equality of (I presume) "material well being" has rarely commanded wide public support, as seen in the actual practices and behavior of the people constituting these societies.[23] Among modern societies I only have to mention Sen's and my own country, India, which for millennia has had a hierarchical society based on the caste system, whose values, as Louis Dumont (1970) has emphasized, do not even recognize the notions of equality and inequality. In such a hierarchical society all are encompassed within their proper stations by the hierarchy, and questions of "equality" in Sen's sense are meaningless. Lest it be thought that the Enlightenment ethics incorporated in the Indian constitution, and rhetorically espoused by its Westernized castes, reflect a change in these more atavistic values,[24] one has only to peruse the marriage advertisements in the pages of various English-language papers in India to see that caste considerations still seem paramount, even among this group, when it comes to vital matters such as whom to wed.[25]

More seriously, even if there were a universal egalitarian distributional ethic, it is not obvious that, as Sen argues the case for

[22]See Berlin (1978) for the various counterarguments to the argument for egalitarianism, which is ultimately based (as he demonstrates) on some form of natural "symmetry" argument, which, itself, requires "sufficient reason" to be upset, but which is deeply ambiguous. Also see de Jasy (1985, pp. 170-81).

[23]I am aware of the inadmissibility of moral arguments based on the naturalistic fallacy (deriving an "ought" from an "is"), but as so much of current moral theory seems to depend on an appeal to common moral intuitions, it is important to note that these intuitions are not generally accepted by all cultures.

[24]Also see Lal (1986c).

[25]When the moral imperialists argue that no sensible person would dispute the force of egalitarianism, I am reminded of the story in the Flanders and Swan musical "At the Drop of a Hat," in which the son of a cannibal returns home and says he won't eat people because "Eating people is wrong." This leads to much derision, and the poor boy is driven into madness, screaming "Eating people is wrong" to the laughter of the rest of the tribe.

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redistributing endowments, we could find a political process that could deliver the goods for the ethically desired realignment of outcomes.

The New Political Economy

This brings me to the fundamental insight of the neo-Austrian view, which until recently has been lacking in the neo-classical view of the market. It has been most fully developed by the public choice theorists, but it also can be arrived at by the neo-classical route (see Krueger 1974) and by the subsequent literature on rent seeking and directly unproductive activities (Bhagwati 1982). This view incorporates and revives various classical insights as found, for instance, in the works of Adam Smith and Karl Marx.

Although problems concerning imperfect knowledge have undermined the implicit assumption of the omniscience of governments, recent developments in what is called the "new political economy" have led to a questioning of the linked assumptions about the omnipotence and benevolence of governments that underlie the tradition of formulating public policy as if it were advice to a committee of Platonic Guardians. It is evident the guardian or so-called public interest view of the state, as well as other views such as the Marxists' view of the idealized Communist state,[26] ignore the fundamental question about the motives of the state. In particular, viewing the state as a guardian of the "public interest" fails to answer the important question posed by Anthony de Jasy (1985) in the first sentence of his book, namely, "What would you do if you were the State?"—nor does it address the more ancient question of "who will guard the guardians?"

A detailed typology of actual and possible governmental forms (in terms of the objectives they seek to subserve) is beyond my remit.[27] But I have recently found it useful to think in terms of two polar types, the benevolent (Platonic Guardian) and the self-serving (predatory) state (see Lal 1984). The objectives of the former are well known as they form the staple of every elementary economics textbook. The objectives of the latter are more murky but must, by analogy with biological predator-prey models, involve the self-serving extraction of the maximum continuing flow of resources (which includes intangibles such as power and prestige) for the members of the government and its associates. Predators will share an interest in

[26]On other such views, see my review of Roemer (Lal 1986a).

[27]The following is based on Lal (1987).

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the enlargement of the incomes of their prey (say, through economic growth) insofar as this raises the potential flow of their own income. Unlike the benevolent state, the welfare of their subjects—as conceived by economists—may only at best be a minor direct component of a predatory state's objective function. More important, however, is the likely opportunistic nature of its behavior, so that when compared with that of the more principled benevolent state, its orderings over social matters are likely to be fickle.

Of course, most actual states will not fall into either of these extreme categories, but it is useful here to maintain this stark contrast. The grand tradition of economics of Marshall, Keynes, Pigou, and others has tacitly assumed that it was by and large working out the economics for a benevolent state. This in itself was not an unreal or absurd assumption. For, as Robert Skidelsky's (1984) biography of Keynes shows, by its excellent description and dissection of the intellectual and social milieu of Edwardian and post-Edwardian Britain, English economists of the day could reasonably assume that the governments they were advising were either benevolent—made up of people like themselves—or, even more important, could be directly influenced to serve the commonweal as viewed by these self-proclaimed Platonic Guardians.

The resulting paternalism underlying this mandarin view, which is by no means stifled in the breasts of many economic advisers, particularly to developing countries, is best summed up in Douglas Jay's immortal words, written in 1937:[28]

> Housewives on the whole cannot be trusted to buy all the right things, where nutrition and health are concerned. This is really no more than an extension of the principle according to which the housewife herself would not trust a child of four to select the week's purchases. For in the case of nutrition and health, just as in the case of education, the gentleman in Whitehall really does know better what is good for people than the people know themselves.

But as the Platonism of the Guardians has slipped even in Britain, that whole splendid body of elegant, sophisticated, and subtle theory that leads from Ramsey, Samuelson, Meade, Little, and Diamond-Mirrlees to Atkinson and Stiglitz, based as it is on the assumptions of a benevolent state run by Platonic Guardians, increasingly appears naive and unrealistic. I will cite but one example.

Those of us who have been raised to accept arguments justifying various forms of governmental action as a solution to the "assurance

[28]As quoted in Howarth (1985, p. 30). If mandarins do have relevant knowledge not generally available to the public, they should diffuse it to the populace.

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paradox" (see Sen 1967) must find the recent savings behavior in developing countries paradoxical. It has been argued (and incorporated in the project evaluation literature) that the social rate of discount must be lower than the private rate of time preference, on the grounds that society as an immortal collectivity would wish to save more than mortal individuals. The latter would thus sign a social compact to save more than they would atomistically. Governments as a result were charged by the "grand tradition" with the task of using the choice of public projects as an indirect means of raising national savings above the suboptimal levels resulting from individual choices. Apart from the obvious "project illusion" on which this argument must be based (see Lal 1973, p.123), it is not applicable if a predatory rather than a benevolent state is assumed as the executing agency of this social compact.

No vast empirical research is required to test the assumptions of this view. All we need point to is the amazing "stylized fact" that (except for Sub-Saharan Africa since 1973) household savings in developing countries have risen consistently over the last two decades to levels that, in Arthur Lewis's view in the *Theory of Economic Growth*, should have led to self-sustaining growth in most of the Third World.[29] At the same time one distinguishing feature, at least of the last decade, has been the prodigal behavior of the public sector nearly everywhere. Instead of supplementing national savings, most Third World governments have been depleting the household savings pool through budget deficits and the losses of public enterprises.

From the perspective that views most states as being closer to the "predatory" end of the spectrum, this is hardly unexpected. Countries and societies may be immortal (though even that is dubious), but *governments* certainly are not. Concerned about their tenure, which is likely to be much shorter than the average individual's lifetime (and that of his offspring), the government's rate of time preference is likely to be much higher than that of private individuals. Hence the observed savings behavior.

Convergent Views of Collective Action

Both the neo-classical and Austrian visions of the market use a notional equilibrium as the fulcrum of the order toward which the

[29]See Lal and Wolf (1986) for empirical substantiation of these assertions.

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market economy moves.[30] Despite their divergent attempts at explaining the market process, due to differing views of the environment (primarily concerned with the nature of uncertainty) facing economic agents, both traditions recognize the need for collective action—and both reach similar practical judgments on the relative efficiency of markets and mandarins in organizing economic life. Thus from both perspectives the choice is not the stark one between markets or the state. Apart from anarchists, I do not know of any economist who would want to do away with mandarins altogether. That is why characterizing all supporters of the market as adherents to a laissez-faire dogma (as Keynes recognized in *The End of Laissez-Faire*) is at best a debating point.[31]

In this context it is surprising, as I have noted elsewhere (Lal 1983, pp. 45–47), that Sen should argue that "the difficulty—in reading great significance into the performance of South Korea as a success story for the 'invisible hand'—is the fact that the hands that reared South Korean growth were very visible indeed" (Sen 1983, p. 13). Elsewhere in the same article he makes clear that by the "invisible hand" he means laissez-faire. Thus he writes, "while the 'converse theorem' is a tribute *to the market mechanism,* it is not a tribute to the *invisible hand, i.e., to the market unassisted by political intervention*" (p. 5). But who has ever argued that Korea's success is a demonstration of the validity of laissez-faire?

The important distinction in explaining the relative performance of different developing countries is not in terms of an active state versus a state that does nothing. Even Bauer (1984, p. 28), who many consider to be a free market ideologue, argues:

> Criticism of central planning or of the policies pursued in its name must not obscure the importance of the essential tasks of govern-

[30]Some criticisms of the notional equilibrium concept, for instance, those of Lord Kaldor (1972), are unsustainable. Hahn (1974), in a splendid paper that imaginatively weaves together aspects of the neo-classical and Austrian views of the equilibrium of a market *process,* rightly castigates the idea that the absence of perfect competition—due primarily to the ubiquitousness of increasing returns (which recent work on contestable markets within the equilibrium framework demonstrates is the least likely cause of market failure [see Baumol et al. 1982])—means that *all* efficiency claims for the market are spurious. For, as both modern neo-classicists and neo-Austrians emphasize, the actual disequilibrium economies we observe cannot thereby be castigated as inefficient, nor can every government intervention then be justified solely on these grounds to serve the particular observers' personal definition of efficiency or equity.

[31]As Michael Lipton has rightly pointed out to me, it is equally as much a debating point "to paint all advocates of the design of central policy in order to *affect* prices and endowments as being 'against the market,' 'mandarins' or believers in a benevolent and neutral State" (Lipton, private correspondence). I have noted elsewhere (1983) precisely this point.

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> ment. The adequate performance of these tasks is indeed helpful to the effective operation of the market, if not necessary for it. The tasks include the successful conduct of external affairs, notably the defense of the country, and also the preservation and encouragement of external communications contacts; the maintenance of public security; the effective administration of the monetary and fiscal system; the promotion of a suitable institutional framework for the activities of individuals; and the provision of basic health and education services and of basic communications.

The successful economies are not laissez-faire economies. Korea and most of the other so-called Newly Industrializing Countries (NICs) in the Third World certainly have activist governments, nor have they fully succeeded in avoiding policy-induced distortions in their economies, but, in comparison with the less successful developing countries (such as India, Sri Lanka, and Tanzania),[32] they have concentrated the state's energies and resources *relatively* more on doing those things that only governments can do and less on those areas of economic life that are by and large best left to private agents.

The accumulating empirical evidence of the gross distortions that mindless dirigisme has created in many developing countries[33] should (as it has) convince even the most skeptical that purely as a practical matter, and irrespective of one's theoretical position, the pendulum has swung too far against the market in most of the Third World. In this sense, it is now a fair professional judgment that in many developing countries most of the more serious distortions are due not to the inherent imperfections of the market mechanism but to irrational government interventions, of which foreign trade controls, industrial licensing, price controls, and various forms of inflationary financing of fiscal deficits are the most important.[34] Thus, regardless of theoretical beliefs and differing judgments about where the ideal line between the market and the state should be drawn, these practical arguments should suffice for economists as a group to unite in urging Third World governments to liberalize their economies.[35] Without

[32]On a comparison of Indian and Korean industrial development, see Lal (1986b). On the relative lack of success of Sri Lanka during its dirigiste phase see Lal and Rajapatirana (1986); Bhalla (1986); and the exchange between Sen and Bhalla in Bardhan and Srinivasan (1986). On Tanzania, see Coulson (1982) and Collier et al. (1986), who argue that its dirigisme has led to an imploding economy.

[33]Which has put them well within their potential production possibilities so that removing these distortions would lead to a movement toward the frontier (assuming all goods are normal) and would imply an improvement in terms of any ethical welfare function.

[34]See Harberger (1985); Little (1982); Lal (1983) for evidence.

[35]That is, remove the grossest of those policy-induced distortions in the working of the price mechanism, which cannot be justified even on dubious second-best grounds to subserve efficiency or equity.

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settling any more fundamental disputes, this nevertheless provides a practical agenda for reform. As Queen Elizabeth I said in another context, as long as her subjects were willing to swear allegiance to her, "she would not . . . make windows in men's souls" (Elton 1955, p. 264).

It is therefore astonishing that some development economists consider it ideological to urge Third World countries to liberalize their economies. The dictionary defines "ideology" as "thinking or theorizing of an idealistic, abstract or impractical nature; fanciful speculation." I find it amazing that those who recognize the gross policy-induced distortions in most Third World economies would nevertheless resist the inevitable conclusions that pragmatism now dictates, on purely theoretical or emotional grounds, and label the advocates of liberalization as ideological. This is surely a case of the pot calling the kettle black.

Nor, so far as I can judge, do most moral critics of markets advocate their extinction. Thus Sen (1985, pp. 18-19), discussing "the moral standing of the market," concludes:

> The argument that is much harder to dismiss is one that claims little for the market mechanism except superiority over other *practical* alternatives. Indeed it is not unfair to ask a critic of the market mechanism what precise system he would put forward *instead*, how well does it work, and how does it compare? When all the qualifications have been put in, the market mechanism certainly has some instrumental moral relevance, related to its handling of information and incentives.

It is not because of the "internal logic" of the neo-classical research program, or because of any great falsification of its predictions, that the neo-Austrian insights regarding the information and incentive functions of markets and prices have been incorporated into mainstream economics. Nor is it because there has been a neo-Austrian, neo-liberal scientific revolution in economics. For as Hicks (1975) has noted, unlike the natural sciences there are no real scientific revolutions in economics, in the sense of a more powerful or general theory superseding others. Most revolutions in economic thought are more in the nature of "a change of attention." Economic theories underpinning beliefs about how the world could, should, or does work, which at particular times are fairly appropriate, are subsequently rejected or neglected because in the course of time they have become inappropriate in light of changing circumstances. But this does not mean that the older theories disappear or are superseded as in the natural sciences.

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Therefore, despite the recent shift of attention, we must not imperialistically limit our conversations (the rhetoric of economics, in McClosky's terms) to members of one sect or creed. In their different ways, those lonely figures Hayek and Bauer have kept alive an alternative way of looking at the world that would not have been possible if Hahn's recent positivist prescriptions for the proper conduct of economics had been universally implemented. There *is* a role for "preachers." But equally we must not let visionaries (on either side) blind us in our practical thinking about the commonsensical and obvious so that the best becomes the enemy of the good.

The Role of Political Economy

Hahn (1985, p. 1399) makes the following distinction between "economics" and "political economy":

> The political economist seeks to understand economic events and arrangements in the framework of a comprehensive social theory, or at least as part of a social totality. . . . The economist, by contrast, sets out to study the "economic" in isolation from the "social" not by ignoring the latter but by taking it as given.

He then goes on to admit "there is substance to the complaint that economists have too sparse a description of the constraints under which agents act in society, and too narrow a view of the motives of actions." Hahn concludes:

> But if forced, I will choose economics and that for two reasons: first, one can understand what it has to say and second, that it attempts to say only those things which have a chance of being understood. That limits what it can claim to know or do. There are many economists who pretend otherwise. To account for them is a task for political economy.

Elsewhere Hahn (1984) makes clear that for him economics is coterminus with current mathematical economics and I suppose econometrics.[36] This forms part of his positivist methodological stance (see Coddington 1975; McCloskey 1983 for critiques). However, as illustrated by the neglect of certain neo-Austrian insights of market processes (and as emphasized by Keynes,[37] one of Hahn's apparent

[36]There also seems to be an assumption that the new political economy is not rigorous, but this is false. As the work of Krueger, Becker, Findlay and Wellisz, Bhagwati, and Srinivasan attests, standard theoretical tools and modes of arguments are being employed in developing the new political economy.

[37]See Keynes's review of Tinbergen's work in the *Economic Journal* and the subsequent exchange of letters with Harrod, all reprinted in Keynes (1973).

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heroes), this failure to comprehend anything not put in symbols must certainly impoverish the mind.

Nevertheless, when Hahn (1984) discusses rational expectations, the austere pose of the scientific applied mathematician sticking to his last begins to slip. He is "scandalized" by monetarism and the new macroeconomics (p. 13). He finds the strategic interaction between the policymaker and the public, which is the basic insight of this new macroeconomics, to be a "not very deep observation" (p. 123). And, most extraordinary of all, he believes that "on the basis of this specious nonsense Keynes has been pronounced dead and Mrs. Thatcher advised" (p. 125).

I am not concerned with assessing the relative merits of Keynesianism and the new classical macroeconomics, but there are four interesting points to note. First, Hahn's wrath is expended against a mathematical theory that he (erroneously) believes is the reason why so many no longer find Keynesian panaceas persuasive.[38] Second, he rails against the descriptive content of the rational expectations theory, while at the same time judging the equally unrealistic general equilibrium theory as a beautiful theoretical construct. Third, he commends Keynesian policies even though, as he himself admits, there is no logically tight Keynesian model available, nor one whose empirical validity has been established in any scientific manner; thus his belief in the validity of Keynesian panaceas could hardly be justified by his austere positivist standards. Fourth, as an organizer of the famous letter of 364 British academics who predicted dire consequences for Margaret Thatcher's policies, he has not followed his own advice that:

> Economists who seek to influence people in power soon come to resemble their patrons. Moreover, they come to feel an urgent need to defend what they proposed through thick and thin. Add this to political beliefs and one is well on the way to explaining some of the zealotry. My own position is that economists are at their most

[38]For a more persuasive account of why Keynesian fiscalism and easy money are not sensible policies to deal with stagflation, see Haberler's contribution in Lal and Wolf (1986). Haberler shares Hahn's jaundiced view of rational expectations, but he equally recognizes the limitations of Keynesian policies in the stagflationary conjuncture. He rightly stresses the importance of the "classical" prescriptions—sound money, tight fiscal policy, and a reduction of rigidities, particularly in the labor market, to deal with these problems. Though I have argued against the views of mathematicians that have lent support to mandarins rather than markets, I am not suggesting that the mathematicians have had much (or any) influence on mandarins or public policy. Alan Walters is therefore right in his comments in noting that apart (in this sense) from some minor aiding and abetting of mandarins, mathematicians must be absolved of responsibility for the dirigisme of the post-World War I period.

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> useful when they give an account of the alternative scenarios which the present state of our knowledge allows [1984, p. 8].

The reasons why Keynesianism no longer persuades many economists[39] are not due to any rational expectations mathematical model, but, first, to the gradual recognition that many Keynesian prescriptions relied on the questionable assumption that ignorant private agents react passively to the macroeconomic policies devised by well-informed and well-meaning public agents. Increasingly, the authorities were seen to be engaged in a strategic game with private agents, who were at least as well informed as themselves, and who had incentives to undertake countervailing actions to undermine the intended outcomes of public policies. Second, as the public choice theorists argue, in democratic welfare states self-interested politicians with a necessarily short time horizon will have a natural tendency to be inflationists. Third, the problems of stagflation and increasing unemployment need to be tackled at their source by removing the institutional rigidities that are their prime cause.

These insights are increasingly denied to the mathematical economists with their self-imposed blinders against what Hahn terms "political economy." But if, as I have argued, most economists are ultimately writing essays in persuasion, the advice proffered by Hahn on the proper nature and scope of economics will make most economists mere applied mathematicians—dullards who few would want to engage in any conversation. This is not an argument against the use of mathematical methods in economics, or against rigorous analysis (which need not necessarily be couched in mathematics), but rather to suggest that to make the subject matter of economics coterminus with a particular type of applied mathematics, as Hahn seeks to do, is to impoverish the subject by narrowing our minds.[40] I would instead endorse Keynes's (1951, p. 141) judgment:

> [T]he master-economist must possess a true *combination* of gifts. . . . He must be mathematician, historian, statesman, philosopher—in some degree. He must understand symbols and speak in words. He must contemplate the particular in terms of the general, and touch abstract and concrete in the same flight of thought. He must

[39]Which in the U.K. began not with Margaret Thatcher but her predecessor, the Labour prime minister, James Callaghan.

[40]I agree very much with McCloskey (1983, pp. 511, 515) that

> economic intellectuals should not discriminate against propositions on the basis of race, creed, or epistemological origin. There are some subjective, soft, vague propositions that are more persuasive than some objective, hard, precise propositions. . . . The cure would not throw away the illuminating regression, the crucial experiment, the unexpected implication unexpectedly falsified.

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> study the present in the light of the past for the purposes of the future. No part of man's nature or his institutions must lie entirely outside his regard. He must be purposeful and disinterested in a simultaneous mood; as aloof and incorruptible as an artist, yet sometimes as near the earth as a politician.

As economists increasingly recognize that the state is not a disembodied, omniscient, omnipotent, and benevolent entity, but made up of self-interested persons like ourselves, it becomes necessary to think hard and clearly of the ways in which we can make these our agents serve our ends. The new political economy—which Hahn eschews—while still in its infancy, holds some promise of answering this question. It is an area of research, both empirical and analytical, that is likely to have the greatest pay-off. It can be as rigorous as most of economic theory. Consequently, contrary to Hahn, we all need to be political economists in the classical sense. Peter Bauer is *par excellence* a political economist.[41]

Finally, in writing our essays in persuasion one has to judge one's audience. Peter Bauer's correct arguments were seen as those of a dissenter in the 1950s and 1960s partly because they were not couched in the positivist terms that carried conviction in the existing climate of opinion.[42] It is the accumulation of empirical evidence, as well as the developments of the theoretical antidote to the "market failure" based dirigiste dogma within the mainstream of positivist analysis, that has led to the changed perceptions of development policies—namely the importance of markets and incentives and the limits of government intervention and central planning. I wrote a popular book (Lal 1983) summing up these developments, which to my astonishment many people seem to have found persuasive. But among those who did not like it was a reviewer in the Cato Institute's *Policy Report*.[43] The criticisms were from a neo-Austrian perspective, which is fair enough, but they misjudged the purpose of my essay in persuasion. As I argue in this paper, neo-classical economics properly interpreted, as well as neo-Austrian economics, reinforce the case for markets. Hence, given the positivist temper of the times, friends

[41]Whatever view one might take about Peter Bauer's castigation of foreign aid, it is important to recognize that his observations that foreign aid induces (a) the formation of anti-Western coalitions of Third World states, and (b) the alteration in the behavior of recipient governments that become "aid-addicts" can be derived from an application of simple economic principles to the behavior of political agents. They are insights of political economy.

[42]See, for example, the exchange between Stern (1974) and Bauer (1975).

[43]See *Cato Policy Report* (July/August 1984).

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of the market would be well advised not to reject even the limp hand proffered by "second best welfare economics."

As recent polls of economists have shown,[44] there is relatively greater agreement among them on the importance of the market than among the lay public and the mandarins, who, as Henderson (1985) documents, are natural "do-it-yourself" economists. For economists interested in public policy, it is more important to convince the mandarins and their principals of the recognized (though some would say limited) virtues of the market than it is to enter into scholastic debates that seek to convert one group of economists to another's abstract vision of the ideal balance between markets and mandarins. In this task of public education, through the lucidity of his thought, the clarity of his prose, and his unflinching vision, few have been more persuasive than Peter Bauer, and I am pleased to be able now to pay him his due. But in understanding the paradox of his unjustified past neglect, it is also important to note that, though ultimate glory may await those who stand against their time, to be influential, the pamphlets we write must to some extent be in tune with their times.

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[44]See Brittain (1973); Kearl et al. (1979).

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Frameworks for Thinking About Reality

Alan Walters

On first reading Deepak Lal's (1987) paper I was profoundly depressed by the contents. I was so completely in agreement that I was nodding away at point after point—realizing, with a sense of concern if not panic, that I would have nothing to say. So I had to read it again. Then I realized that, naturally enough, I had read it with the object of discovering echoes of my own beliefs on, for example, the irrelevance of much mathematical economics. Such examples I found in full measure, and I can only applaud the elegance and élan with which Lal has dissected the litany and the literature. But I do not think Lal can sustain the argument that the dominance of the mathematical (Arrow-Debreu) rhetoric is the main reason for the neglect of Peter Bauer's work in the 1950s and 1960s compared with the widespread acceptance of his views in the 1970s and 1980s.

In fact the dominance of the mathematization of economic theory in academic institutions has undoubtedly increased sharply since the 1950s, just as the appreciation of Bauer's distinctly amathematical contributions has burgeoned. Similarly, a cross-sectional study of countries would show that Bauer's stock is highest where the mathematicians are most ubiquitous (that is, the United States), and that he is less well known where mathematical economics is all but unknown or regarded merely as uninteresting esoterica, such as Germany and Japan.

But as Bauer would affirm, correlations have little substantive meaning. One must go behind the data and observe the real situation or process that generated such statistics. I believe the essence of an explanation is to be found in the binary split of the economic genre—one into the mathematics of elegant models of great aesthetic appeal,

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the other into attempts to understand the real world of institutions, constitutions, and incentives. Elegance is the main aim of the mathematical models. But of course the mathematical economists could hardly avoid claiming that such elegance was also relevant; mathematics that is not pure must have some relevance to reality if it is to be accepted as valuable. It should, so to speak, provide some sort of framework for thinking about reality.

Perhaps it does—at least for mathematical economists. Yet, since World War II, the remarkable fact is that virtually all significant advances in economics—and by that I mean advances that affect the way economic advisers go about their business—have owed little or nothing to mathematical economics. The permanent income hypothesis (PIH), the revitalization of money, the Coase theorem, the Buchanan-Tullock political economy, and even those theorems showing the "neutrality" of finance—none emerged from mathematical economics. And generally speaking (perhaps the most notable exception is the PIH) these advances were greeted as either trivially obvious or most dubious propositions by the mathematical economists.[1] Yet they survived this cold academic shoulder and certainly changed attitudes toward policy, largely because there was clear evidence to support their approach.

Thus it was not because of his epistemology that Bauer (and Hayek) was neglected in the 1950s and 1960s, but rather because the world had to wait a few years to review the effects of the massive growth of the state that began in the 1950s and burgeoned in the 1960s. By the 1970s it was clear that Bauer's analysis and predictions were validated; peasant supply curves did not bend backward, central planning did not beget prosperity, and the vicious circle of poverty was shown to be merely a cipher.

In my view the initial hostility to Bauer was much enhanced by the fact that he used simple, basic analysis, but used it in the most sophisticated, logically tight way. Rather like Milton Friedman, from a few simple principles of economics and with almost a pedantic penchant for logic, accuracy, and evidence, Bauer derived results that surprised and even shocked the profession and the clerisy. He defeated the fundamentalist dirigistes on their own ground and with their own weapons. And if so much could be achieved with so little, was this not an indictment of those arid acres of mathematical manu-

[1]A possible candidate for this list of advances is Arrow's Impossibility Theorem, which showed that majority voting, inter alia, would not achieve Pareto optimality. It seems to me, however, that Arrow was simply providing a proposition that most economists had long accepted as common sense. It was not surprising, as was the Coase theorem or the PIH.

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scripts that suffocated the professional landscape? Small wonder the profession was driven to denigrate such simplistic reasoning (as exemplified in the remarkable attack by Nick Stern and his gang), especially when the mathematical methods of planning (such as input-output analysis) were going through such lean periods. But such a critique of Bauer grew increasingly threadbare as his arguments were more and more accepted by the sophisticated lay public. Even while Armartya Sen beavered away at attempting to undermine the credibility of Bauer's evidence, such as claiming the miracle Newly Industrializing Countries (NICs) were really an illustration of dirigisme, Sen had to accept much of the substance of Bauer's analysis, largely because, had he not done so, Sen would have lost his credibility and much of the lay audience he was so anxious to return to the pre-Bauer fold.

But more important, the origins of dirigisme and the academic denigration of Bauer did not originate in, nor, in my view, was it much augmented by, the mathematical economics of the 1950s and 1960s. Similarly, if my contacts with those august persons do not deceive me, the mandarins already embraced dirigisme long before the mathematicians began to provide rationalizations. The view that the market mechanism did not work became pervasive in Britain in the interwar years. The contributions of Sraffa, Shove, and Joan Robinson were thought to have demolished the idea that free markets could conceivably be an efficient and equitable way of allocating resources, and, on the other hand, the tales of political pilgrims of the success of Russian communism provided the working model of an alternative controlled economy. Institutional nepotism (with adopted children) ensured that Cambridge, the cradle of economics for more than a century, promoted the dominant paradigm of the necessity for central planning. Similarly, Oxford, in the form of Balogh and his acolytes, was soon under the dirigiste dogma. One of the remarkable features of this Cambridge conversion was that the leaders largely rejected mathematical economics as mumbo jumbo or, as Joan Robinson said, mathematics was a "substitute for thought." (This remarkably revealing phrase shows the degeneration of Cambridge economics. First, thought is the scarcest commodity, and so one would welcome some substitutes as valuable additions to resources. Second, the phrase illustrates the hostility to the basic idea of substitution—the linchpin of classical economics—and the embracing of Marxian notions of fixed proportions and no substitution. No doubt mathematical economics has a lot to answer for, but not as a substitute for thought.) Indeed the most distinguished of this fraternity were innocent of mathematics. Similarly, the influential

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American planners, such as John Kenneth Galbraith, eschewed mathematical economics, certain in the knowledge that, without any such assistance, he knew how to control prices and incomes and considerably improve upon market performance. Oddly enough, the Galbraith amathematical approach received some weak support as the application of input-output methods to the Western economies soon exposed their great weaknesses as practical guides to planning economies. An economist mandarin indeed.

Mandarins are naturally inclined to distrust and dislike the messy activity of business, particularly competitive business. British mandarins rejected business as a suitable career when they chose to enter the civil service for virtually their entire working life. The ambient ideology of Oxbridge cultivated the view that, left unregulated, particularly the smaller businessmen were up to little social good.

Planning came naturally to such an elite. I suppose it was of some assistance when the mathematical economists, who, however much disliked by the ancien régime, were obviously very clever indeed, provided rationalizations, even a planning process, for different forms of controls. But it would be unwise to give too much credit or rather blame to the mathematical economists. After all, one of the most brilliant mathematical theorists and one of the most abundant sources of absurdities, Frank Hahn, is reckoned to be the leader of the *right* wing at Cambridge. So I think we must declare the mathematicians as largely innocent of promoting, as distinct from latter-day aiding and abetting, socialist dogma.[2]

But what of the cultural imperialism of neo-Austrians? And how does Bauer's work relate to these competing empires? Whatever the shortcomings of many neo-Austrian ideas, the overwhelming contribution of Hayek and the other founders of the Austrian tradition was to emphasize, first, that the normal state of man was one of ignorance, not knowledge, and, second, that there are severe and very restricting

[2]I believe also that the mathematical economists and even the econometricians can be declared innocent of the main resurgence of dirigisme in 1986, namely, the drift toward another system of controlled exchange rates. Nonmathematical economists, such as John Williamson and Fred Bergsten, declare that they can define the fundamental equilibrium exchange rates (and they mean *real* exchange rates), that they can measure the fixed equilibrium exchange rate (FEER) with an acceptable degree of accuracy, and, finally, that they can design monetary-fiscal-intervention policies that will bring economies back to the FEER. They have apparently convinced the U.S. Treasury that they, or perhaps members of the treasury, command these extraordinary talents, and that by employing them the international economy can reach a higher level of performance. Such a new-found dirigisme will have consequences far beyond the supposed righting of allegedly wrong exchange rates, as I have tried to explain elsewhere (Walters 1986, ch. 7).

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limits on what is knowable. Third the subjectivist view emphasized the organic development of institutions reflects a process of experiment and discovery, human error and triumph—a spontaneous order.

I agree with Lal that Bauer's work, like that of the Austrians, is classical in approach and method. He distrusts long chains of abstract reasoning, where one might easily lose contact with reality. He prefers the simple and short links of basic price theory, and he continually seeks to check his reasoning by close observation and understanding rather than by superficial statistical corroboration. He is impressed by the revealed performance of people with few or none of the "privileges" of education when they are free to work and make contracts in the ambience of social order. This view of the market is based in part on a careful consideration of theory, but in the main it is supported by Bauer's intimate knowledge of market processes in, for example, the rubber industry of Malaya and in the manifold petty trading of Africa. In my experience, most economists who actually take the trouble to know an industry or a set of markets emerge from this process of learning with an abiding respect for the market process. Such a respect is also counterpointed by an understanding of how *little* we know in the economics profession. Indeed the Austrians are right: the abiding quality of the economist, so rarely acknowledged, is his ignorance.

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Diseconomies of Scale and Development

Mancur Olson

Introduction

Those readers who are not only familiar with Lord Bauer's work but also have some acquaintance with my writings probably would not have expected that I would be among the contributors to this Festschrift. Many people know that Lord Bauer's work has been distinguished by its high scientific quality, as well as by a steadfast adherence to a somewhat conservative (or at least classical-liberal) point of view. A few readers may also know that my writings are not inspired by quite the same conviction; I believe that neither left-wing nor right-wing ideologies provide an adequate understanding of the problems of our time. I have even gone so far in some recent essays as to argue that the ideological debate that occupies many leading economists and other intellectuals often confuses rather than clarifies our thinking.[1]

The familiar ideological categories are not, of course, well defined; in any complete analysis, the terms "conservative" and "classical liberal" would have to be sharply distinguished. None of these ideological categories in any case captures the undoubtedly scientific and uncommonly observant character of Lord Bauer's writings. Still, these categories do in a loose sense capture a significant if secondary aspect of his writing and reputation.

Since, to some extent, Lord Bauer's writings fall in one of the ideological categories I oppose, why am I so quick to honor and publicize his writings? It is not enough to say that, like most other economists, I often admire and profit from writings with which I

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[1]See, for example, Olson (1986).

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partly or wholly disagree. My admiration for Lord Bauer's scientific achievements has other sources as well.

The particular source of my admiration of Lord Bauer's writings that is most relevant to this essay is rooted in his focus on the economic development of the poor or developing areas of the world. It is sometimes supposed that the case for a competitive market economy is stronger for the prosperous capitalistic countries than it is for those very different societies that have yet to develop. Developing countries, it is sometimes said, are less suited to a market economy for cultural reasons, in that their peoples allegedly do not have the same rational and maximizing habits of mind that are usually assumed in the economic theory that has emerged in the economically advanced countries of the West. The less developed countries are also thought to need higher levels of protection of manufactures, in part on "infant industry" grounds, than the already developed nations require. Moreover, poorer countries are also supposed to be especially susceptible to exploitation by multinational corporations and foreign capital, and perhaps to have a special need for economic planning.

In this essay I offer a reason why I believe Lord Bauer's general policy recommendations are of *greater* pertinence and value to developing countries than to developed ones.[2] The argument that competitive markets will greatly help to solve the problems of underdeveloped countries is, in my opinion, far stronger than the contention that advanced countries should rely on such markets; the poverty problem that still afflicts a small but significant minority of individuals in the most developed nations is, for example, a better candidate for activist governmental programs than is the problem of promoting economic growth in societies that have so far failed to develop economically. The optimal role for government is actually smaller in developing countries than in advanced ones.

[2]The argument in this essay was first presented at academic gatherings in the mid-sixties. (For example, at a session of the Midwestern Economic Association in Chicago on 17 April 1964, and at a seminar at Columbia University. The presentation was then entitled "Economic Growth and Structural Change.") My argument was not at that time well received. Accordingly, I decided not to submit it for publication until I could somehow make the argument clearer and more persuasive, or until the *Zeitgeist* should become more receptive to it. Probably it was mainly the inadequacies of my evidence, or the shortcomings of the way I presented it, that explained the negative reaction in the 1960s. Still, there has been a considerable change in professional thinking about economic development since then, so perhaps my argument now will be received more indulgently. This argument, moreover, probably resonates more with Lord Bauer's writings than anything else I can do. Thus, I hope that the improvements I have made in my argument and the change in susceptibilities since the 1960s will make this essay an appropriate tribute to Lord Bauer.

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The optimal roles of the market and the government in developing as compared with developed countries depend, as we shall see, on what has most delayed or prevented development of the poor countries. What missing factor or input has been most important in keeping those undeveloped areas from developing? Are the cultures or other attributes of underdeveloped areas such that markets will not work very well? Or are these areas especially lacking those things needed to make governments, enterprises, and planning agencies work? It is helpful in this connection to look at various factors or shortages that in the past have been thought to have prevented development of poorer countries.

Traditional Explanations of Underdevelopment

When the study of economic development first became a standard specialty in economics departments shortly after World War II, the most popular explanation of the continued poverty of the poor nations was their lack of capital. Capital at the time meant mainly machinery and other tangible capital rather than human capital. Ragnar Nurkse's book *Problems of Capital Formation in Underdeveloped Countries* (1953) is typical of the best of the literature that looked on a shortage of physical capital as the main problem of the less developed parts of the world. Very poor people cannot be expected to survive if they use a large proportion of their incomes for investment, but rich people are not correspondingly constrained, and this fact made it natural to focus on shortages of capital in poor countries.

Though the significance of the size of the capital stock for any nation's output cannot be denied,[3] the notion that a shortage of capital is the main cause of poverty in developing nations has come to be questioned on all sides. In most countries, for example, there is some capital, such as private holdings of gold and silver ornaments, that is not productively used. A second and more important objection is that if there were not other difficulties (such as political instability, economic nationalism, or poor management), capital could always be borrowed from prosperous countries; if capital had in fact been in particularly scarce supply in the poor country, its "marginal productivity" and so the profitability of its use ought to be greater than in the prosperous countries. The low growth rates of many countries that received nonnegligible amounts of foreign aid and the low pro-

[3]Strictly speaking, there is no altogether satisfactory way of defining the stock of capital, and thus its marginal productivity, independent of the interest rate, in a completely aggregative analysis. With a poor country that is too small to affect the "world" interest rate, though, there can be no objection to the formulation in the text.

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ductivity of some modern factories that were built in poor countries have further lessened the credibility of the "scarcity of capital" explanation of underdevelopment.

Somewhat later there were many advocates of the view that the missing ingredients in most poor countries were skilled manpower or educational systems that could impart needed skills. This view, naturally enough, drew strength from economists' emphasis in the early 1960s on the theory of human capital. A large stock of human capital can, of course, be profoundly important to a country's development. As a general explanation of the failure of most poor countries to develop, however, the emphasis on human capital will not do. Many of the poor countries today have far higher proportions of educated people in the labor force than the now-developed nations had when they were developing. Although India may have, as is alleged, more trained engineers than the United States, it is nevertheless true that there are high unemployment rates among well-educated people in India and other poor countries. Developing countries as a whole are also net exporters of highly educated manpower. If a shortage of skilled manpower were the only major obstacle to development, the marginal products and the wages of scarce skilled workers would be higher in the poor countries than the rich ones, and this net export of educated talent would not occur.

A poor country that is lacking people trained or experienced in a particular specialty can hire the relevant specialists abroad, albeit usually only by paying somewhat more than the standard wage for such labor in Europe or North America. Thus, important as human capital presumably is in the development process, it cannot serve as a general explanation of why most poor countries are failing to catch up with developed nations.

Other writers, especially noneconomists, have wondered whether the cultures in most of the poor countries were incompatible with economic development, or at least with the market institutions under which development proceeded in the West. The calculating, acquisitive, and impersonal behavior that is often thought necessary for the effective operation of markets and capitalistic systems is alleged to be lacking in many poor societies, with the result that rational responses to market incentives, and especially entrepreneurial initiatives, are not forthcoming.

Although this essay calls attention to the significance of culture and social mores in another context, the bulk of the evidence seems to me to run counter to the notion that cultural resistance to market incentives is an overwhelming obstacle to the development of poor areas. The propensity to trade, and to seek an advantageous bargain

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when doing so, seems to be more striking in Middle Eastern bazaars than in American supermarkets. The preference for large incomes over small incomes is dramatically evident in nearly every poor country—even the decisions of governmental officials are sometimes for sale. The hypothesis that the peasants or tribesmen of various poor areas would not respond to market prices has been contradicted by several econometric studies of agricultural supply responses in areas such as Pakistan, Thailand, and East Africa. Theodore W. Schultz's (1964) research on Indian agriculture revealed that Indian peasants often come closer to satisfying the marginal conditions for an individual economic optimum than do American farmers, largely because the peasants confront slower rates of technical change and have accordingly had more time to adjust to the relevant production functions and relative prices.

To say that most people in most cultures on which there is available information appear to respond to market incentives in the predicted way does not, of course, deny that some cultural groups may be better prepared than others to respond to these incentives or that in other contexts cultural factors could have a profound significance. At a minimum, an advanced culture must bequeath a considerable amount of human capital to those who are raised in such a culture. One hypothesis of this essay, moreover, is that in one crucial extramarket context, culture is critically important, as will be evident from the constructive argument that follows.

A Nonimportable Requirement for Development

One problem with the once prevalent explanations of underdevelopment is that they overlook the possibility that any single factor of production whose scarcity prevents development usually can be imported. Both tangible capital and highly educated manpower can be imported. If the productive factor is especially scarce, it should—if the institutions, organizational structure, and policies of the country are appropriate—bring exceptionally high returns simply because it is so scarce. Thus it should be surprising if any single factor (or any pair or triplet of factors) that can readily be imported would by itself prevent economic growth. It is to factors of production or growth-causing forces that cannot be imported that we should look for the fundamental difficulties of development.

Cultural habits are not so readily imported as physical capital or educated specialists. There is admittedly some tendency for societies to imitate cultures that are deemed to be successful, and thus a certain amount of cultural importation occurs. But it is more often the super-

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ficial and less subtle cultural characteristics of successful countries that are imported initially; acquisition of the subtler features of an alien culture can take a very long time as well as considerable investments in learning. Earlier in this paper I suggested that individuals in practically all cultures respond in broadly similar ways to the obvious and powerful incentives in markets. Culture, however, can still play a crucial role in extramarket contexts.

The one political attitude that most uniformly categorizes developing countries in recent times is "anti-imperialism." Although the expression often is used loosely, and sometimes means opposition to any relationship with a more developed country, its initial and core meaning is resistance to being governed by citizens of another country—to taking orders from foreigners. Virtually without exception, the people of poor areas (no less than rich ones) have wanted "independence." Independence in this context is not synonymous with "freedom"; resistance to various home-grown autocracies has not in general been so widespread as the opposition to foreign administration. Although subordination to a foreign government is the main concern, some loosely define imperialism to include direct investment by foreign or multinational firms, or foreign control of universities, schools, and other major institutions. Opposition to ideas and products that originate abroad may also surface, but this is countervailed by the imitativeness and readiness for cultural change mentioned above. Thus, control by a foreign government is almost always ruled out in modern developing countries.[4]

It follows that one of the elements needed for economic development— a stable government that reliably provides law and order, impartially protects private property, and enforces contracts—usually is not being "imported" into or imposed upon developing countries, and ordinarily could not be without at least profound and violent resistance. Such "importation" is defined as imperialism and is ruled out, and (in my opinion) usually for good reasons. Moreover, no evidence or promise of high "marginal productivity" from better government will normally overcome resistance to imperialism—better government is a "factor of production" that will not be obtained from abroad even when importing it could bring a considerable increase in income.

[4]To refer to this constraint and to emphasize its intensity and generality is not, of course, to attack the constraint. Subordination of a country to a foreign government in which the colonial people have no voting rights not only opens up the possibility that the imperial power will be used exploitatively, but it also may perpetuate feelings of self-hate, inferiority, and bitterness on the part of the subordinate group.

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There is also today considerable resistance in less developed countries to admitting multinational firms, even though foreign firms are not inherently a form of imperialism. A foreign firm that can only obtain labor and other inputs by paying enough for the owners of these resources to sell them voluntarily, and that can only sell its product to willing buyers on a free market, cannot be coercive. Such a firm should therefore not be equated with a colonial government that rules by force. Nonetheless, most developing countries discriminate more against foreign-owned firms (if they allow them to enter at all) than do most developed nations. Thus, in practice, large foreign-controlled corporate hierarchies are also relatively rare in the poorer countries.

The Special Difficulties of Large-Scale Organizations in Underdeveloped Areas

The objection to importation of foreign hierarchies suggests that *developing countries will be especially short of effective large-scale organizations*—unless this factor of production is something they would have in relatively great supply because of their indigenous characteristics (that is, unless it was a factor of production in which they were intensive, so that under conditions of free trade they would tend to export products for which this factor was especially important). This essay attempts to show that the indigenous characteristics of poor countries are strikingly inhospitable to effective large-scale organization, especially to large-scale organizations that have to operate (as governments do) over a large geographical area. This is true both of poor countries today and preindustrial Western nations.

There are several reasons why the indigenous characteristics of underdeveloped areas are unfavorable to effective large-scale organization. One reason is that capital is relatively scarce in poor countries. This scarcity is not, as was argued earlier, a sufficient explanation of underdevelopment, because in the absence of other problems the needed capital would be imported. Nonetheless, the wage-rental ratio in most poor countries tends to reflect their relatively low rate of savings and their enmity toward foreign capital. A scarcity of capital tends to prevent large-scale production; it is often machines and other capital goods that come in large, indivisible units that give rise to economies of large-scale production, not land or labor.[5]

[5]Industries with no capital goods (apart from inventories) would be less likely to achieve economies of large-scale production; there might be some gain from increasing specialization of labor as an enterprise grew larger, but it would be hard to think of a marketable product, made without the use of extensive capital equipment, that would

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A primitive level of technology also tends to prevent large-scale production, because simple methods, even when they are capital intensive, normally offer no incentive for large-scale production. The development of steam power and the invention of new textile machinery that could not be powered by hand gave rise to the first modern factories. Factories are relatively large-scale establishments, and they became a general and important way of organizing industrial production only during the Industrial Revolution (Ashton 1948, pp. 71–77). Small-scale, or "cottage," industry prevailed when textile machinery was hand powered. It is difficult to think of many types of capital equipment embodying primitive technology that must for efficiency be used in large, indivisible units, and which would therefore give rise to significant economies of large-scale production. Some irrigation works, mining operations, and transport canals in primitive societies were relatively large scale because of the size of the rivers involved or other geological and geographical conditions, but these were exceptional. In most cases, primitive technologies have been associated with relatively small-scale operations.

The low level of per capita income in poor countries also tends to foster small-scale enterprise. The lower the level of per capita income, other things being equal, the smaller the size of the market. Advocates of balanced growth, such as Rosenstein-Rodan and Nurkse, based their case mainly on the fact that in poor countries the small size of the market limits the inducement to invest. But the small market also limits the scale of the enterprise, because when the market is small the demand will not be great enough to sustain a large enterprise even if the shape of the average cost curve is such that it gives a larger enterprise lower costs.

Market size depends not only on the level of per capita income but also on the costs of transportation and communication. The costs of transportation and communication will, however, be closely associated with the level of per capita income. The same shortcomings that keep a poor country from having a modern, low-cost manufacturing sector will usually keep it from having modern, low-cost transportation and communication systems. Obviously, many underdeveloped nations today have imported some modern transportation and communication devices from advanced societies. Most underdeveloped countries have a few modern roads and railroads linking major cities,

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involve so many separate operations that a very large work force would be needed to exhaust the gains from the division of labor. There can also be economies of scale in distribution and marketing, but these economies are usually not as important in developing countries with their poor systems of transportation and communication.

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but transportation systems in rural areas still are often quite primitive. The cost of modern transportation in poor countries is so great that it cannot be provided to the mass of the population. This is also basically true of such modern communication devices as the telephone and television. Many of the people simply cannot afford them.

Such emphasis on the relative backwardness of the transportation and communication systems of poor countries may seem unnecessary, since this backwardness would perhaps nowhere be denied. If it is accepted, however, two further reasons why poor countries should be expected to have relatively little experience with large-scale organization follow inexorably from it. First, poor transportation and communication tend to force a firm to rely mainly on local factors of production. When a firm's scale increases, it will have to go farther afield to obtain factors of production, and the poorer the transportation and communication systems the faster these factor costs will rise with expanding output.

The second and more important reason why poor transportation and communication systems work against effective large-scale enterprise is that they make it far more difficult to coordinate such enterprises effectively. This is particularly true for large-scale enterprises whose activities are relatively far-flung or space-intensive. A large retail establishment, for example, will have a chain of stores scattered over a wide area. And a large manufacturing organization, even if it has but one factory, will often need to be represented throughout the wide area in which it must buy factors of production and sell its product.

The difficulties of communication and transportation in the relatively larger enterprises that did exist in preindustrial periods in Europe are shown by the autonomous authority granted to those in the lower levels of command. In the age of sailing ships, for example, it was common for the ship's owner to give its captain the authority to change his route whenever he decided and to stay away from home port as long as he wanted, because there was no way in which the owner could know of the possibilities of profitable transactions in distant ports. The success of the Rothschild family's financial empire, in part, is credited to unusual family loyalty and to successive generations with large numbers of sons. Only a large and cohesive family could keep the various national branches of the empire from going entirely different ways. These are only isolated examples, but they illustrate the special difficulties large organizations must face in coordinating their activities when transportation and communication are poor.

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Culture and Organizational Size

If the foregoing reasons why large-scale organizations have usually been uneconomical in poor societies with primitive technologies are valid, we should expect that large-scale organizations would not have been as common in either contemporary developing countries or in historical times as they are in rich countries today. To the extent that market forces operated, these forces would make it difficult and disadvantageous for most firms to expand. Resource scarcities would tend to limit somewhat the size of organizations even in the absence of markets.

A systematic survey is needed before we can be certain, but my reading and observation suggest that, as the foregoing arguments would predict, the average size of productive enterprise has been far smaller in poor than in prosperous societies. In each country that has industrialized, moreover, the average size of enterprise appears to have increased enormously since industrialization began.

If small-scale enterprise has been indigenous and generally optimal in less developed societies, and large-scale enterprise has not, we would expect the skills, attitudes, and expectations of most people in these societies to be derived from and geared to small institutions rather than large ones. Since the adaptation to small-scale activities presumably goes back to the beginning of social life, and any experience with large-scale organizations is relatively recent in developing areas, we would expect that the cultural attitudes in these areas would be appropriate only to small-scale enterprise. In addition, because low per capita incomes and primitive transportation and communication also foster smaller markets, and (as Adam Smith first showed) the "division of labour is limited by the extent of the market,"[6] we would also expect less specialization—and cultural characteristics less suited to detailed specialization—in poor societies.

If the above is true, we should expect that the characteristic institutions of traditional societies would be both small and unspecialized. The prevalence of extended families,[7] tribes, clans, manors, and communal village organization tentatively suggests that this prediction is correct. As Joseph Schumpeter (1954) pointed out, even a separate and specialized government financed by taxes is a post-medieval development. The cultures of underdeveloped societies,

[6]This is, strictly speaking, true only if there is some range of decreasing average costs of production, but a somewhat U-shaped unit cost curve is likely for most types of production, or at least for enough to make the generalization in the text true.

[7]"Extended family" does not necessarily entail "multifamily household," as the works of Peter Laslett and others have shown. See Laslett (1972).

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including Western societies in preindustrial times, would again presumably also be adapted to these institutions rather than to the specialized and large-scale enterprise of modern developed countries.

We should, for example, expect that the cultures of poor societies would not produce the "organization man," but rather the "extended family man" or the "tribal man." I hypothesize that such cultures would produce far more loyalty to relatives outside the nuclear family, and more "tribal" loyalty, than is evident in developed countries. On the other hand, we also would predict more nepotism and other forms of corruption in those few large-scale organizations that do exist in poor countries than among corresponding organizations in rich countries. These predictions appear to be true.[8]

It should not be surprising that cultural forces should be more significant in large-scale bureaucracies than in individual behavior in markets. Except possibly when the degree of uncertainty is extraordinarily great, the incentives facing the individual in the market are relatively clear-cut and obvious. No extensive indoctrination or particular ethic is needed to convince the peasant that if he can produce a larger output at the same cost, or the same output at lower cost, he will get more money to spend in the local market. The incentives facing a bureaucrat in a large organization may not be so easily discerned. One's superior must be appeased, of course, but often it is not simply effective work in the interest of the organization as a whole that will best achieve this result. The leader of a large bureaucracy cannot know what each individual is doing and therefore cannot reward precisely the behavior he wants to encourage.

Characteristically, in the underdeveloped societies of today as well as in the preindustrial West, leaders of large organizations have been unable to prevent corruption by their underlings. As the great Indian sage, Kautalya, put it more than 2,000 years ago: "Just as the fish moving under water cannot possibly be found out either as drinking or not drinking water, so government servants employed in government work cannot be found out while taking money for themselves" (*Arthasastra* [1967, 2d book, p. 71]). Thus, that subtle complex of ethics, customs, habits, rules of thumb, and expectations of what others will do, which is often called culture, may have greater significance in the large-scale bureaucracy than for individual behavior in the market.

[8]See, for example, Wraith and Simpkins (1974).

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The Exceptional Difficulties Facing Large Governments in Poor Societies

In any country, the largest organization is usually the government. Would the foregoing arguments apply to it? Most of them clearly ought to, but there may be reservations in some quarters about whether the diseconomies of very large-scale activities that seem to be present in firms in poor countries would also apply to governments. It would, however, be a serious methodological error to allow the conclusions about government to rest on a mere analogy with firms producing marketable goods. It is therefore necessary to consider governments explicitly.

Governments are differentiated from firms and firmlike institutions in developing countries above all by the fact that they produce the collective or public goods that the private sector characteristically cannot produce in optimal quantities. In most cases, public goods have two properties. First, if the good goes to anyone in some area or group, it goes to everyone in that area or group. Second, consumption is largely nonrivalrous, in that additional consumers can enjoy the good without substantially diminishing the consumption of those who are already consuming the good.[9] Defense, pollution control, and law and order are classical examples of public goods that have these properties.

One implication of the nonrivalness characteristic of public goods that seems to have been neglected in the literature is that this feature—when combined with the absence of diseconomies of scale—would lead to ever-larger countries, until in the end there would be only a single world empire. Yet the absence of world government now, or even a government that includes as much as half of the world's population, suggests that something must countervail the public goods logic that leads to even more inclusive governments.

This logic can be seen most simply by asking what is the per capita cost of an army or military force of a given size for countries of different sizes. Suppose, for example, that countries A and B have the same measured per capita income, but that country B is twice as populous. In order to abstract from the conceptually distinct question of what size army each country could raise internally, and to show that the argument being made holds even with the least favorable assumption, let us suppose that mercenary soldiers are available in

[9]Strictly speaking, what is required for the present argument is that the marginal cost of provision to an additional person is less than the average cost per person of providing it. Public goods in this case have both the "nonexclusion" property and the "nonexhaustion" property.

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third countries without limit and that mercenaries are as good as or better than soldiers from the home country. This means that the smaller country can, if it is willing and able to pay enough, raise an army as large as the larger country. Even in this situation, however, citizens of the larger country will tend to be better off than those of the smaller country; and in the absence of both an (historically somewhat exceptional) unwillingness to be imperialistic and the difficulties for large-scale organizations adumbrated above, the larger nation will normally have an incentive through threats or use of force to absorb and exploit the citizens of the small country. This is because the large nation gets just as much per capita strength out of X divisions as the smaller country does (an increased population in a country would not require a larger army), but will have a lower per capita cost. Thus if the measured per capita incomes and values or preference orderings are the same in the two countries, then the larger country will spend more absolutely on military strength than the small one.

Suppose the small country spends half of its national income, and takes half of each citizen's income, to hire a large army of X divisions. The large country (with identical citizens but twice as many) can hire 1.5X divisions and still have decidedly lower taxes than its small neighbor. We must then explain why the two nations do not always merge, in which case each citizen could enjoy the benefits of an army of 2X divisions and also lower taxes than before. Or why the large country does not simply take over the small country and exploit the conquered.

Mergers do occasionally happen (for example, the 13 states that formed the United States) partly for this very reason, and aggression or imperialist expansion by large countries against smaller ones has indeed happened often. Nevertheless, there are enormous difficulties (especially in developing areas) in controlling and administering large territories. These difficulties can be so great that large jurisdictions on occasion break into smaller parts. Indeed, every ancient empire without exception has collapsed and been succeeded by smaller sovereignties, such as feudal fiefdoms or tribals chiefs.

I hypothesize that governments are not only naturally affected by the general difficulties facing large-scale organizations in developing countries,[10] but are even more seriously affected than the average large-scale enterprise, for two distinct and cumulative reasons.

First, governments govern territory, and (as was argued earlier) activities that take place over large areas are particularly difficult to

[10]The view that effective large-scale government is unlikely in poor countries is not

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coordinate, especially without modern transportation and communication. It is likely that the small scale of most agricultural enterprises (except in Soviet-type countries) is largely due, even in the most developed countries, to the difficulties of coordination over large areas. If one worker per square mile is required, a farm with 1,000 employees—not many by the standards of modern industry—would, of course, have to coordinate its activities over 1,000 square miles. It is therefore not surprising that the large corporate structure typical in manufacturing has not also spread to farming, or that the big "bonanza farms" of the late 19th-century Great Plains, and the huge collective farms of the Soviet bloc countries, have been failures.

In underdeveloped societies with poor transportation and communication, the problems of coordinating activities over wide areas are far worse. By governmental standards, moreover, 1,000 square miles is merely a microstate or manorial domain. Thus a government in a developing area that has typical modern dimensions and wants to insure that common policies are followed in all parts of its domain must have tens or hundreds of thousands of functionaries, many of whom are in locations that have only tenuous transportation and communication connections with the national capital. Governments of developing countries thus face problems akin to those of the monarchs who aspired to control the "nations" of medieval Europe. As Marc Bloch (1961, pp. 62–65), the great medievalist, put it, "the only effective authority was one on the spot. Forced constantly to take the gravest steps . . . every local representative of a great potentate tended only too naturally . . . to transform himself into an independent ruler."

The second reason why governments are particularly disabled by the problem of large-scale organization in poor countries is that their single most important function is providing public goods, and it is far more difficult to assess the performance of bureaucracies (and bureaucrats) who provide collective goods than of organizations of equal size that produce market outputs. The greater difficulty of measuring outputs of public goods, and of estimating the social production functions that would determine how much output ought to be attainable from given value of inputs, derives in turn partly from the fact that experiments or experiences with the production of collective goods are inevitably on a "group scale," so that experiments are more costly and the experience per unit of time is less informative.

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new. It would take some searching to determine when and how the notion first took shape. One important and stimulating statement of this view is in the paragraphs on the "administrative revolution" in Hicks (1969). I put the notion forth in Olson (1965), especially pp. 551–54, and in the mid-1960s paper out of which this presentation grew. Very probably the point was first made long ago.

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This difficulty reduces the technical efficiency of public goods production.[11] Though the special problems of assessing performance and attaining technical efficiency hold in both developed and developing countries, limited information about performance is a far more troublesome problem when cultural attitudes (which especially affect "unobserved" actions) are unsuited to large organizations and when transportation and communication costs limit a leader's access even to such information as is available on the spot.

The fact that the per-capita cost of providing a given level of military capacity would fall as the number of people receiving the public good increased would (as indicated above) tend to make governments expand to the point of world government. The hypothesis that, in poor and primitive societies, the cost of providing law and order and administering common policies rises with the size of the area governed, however, tends to set severe limits on the amount of "government" an underdeveloped government can provide. These limits must restrict either the total area governed or the quality of public goods provided for a given area. Thus, in poor and truly underdeveloped areas, the government must usually be either very small (as were medieval governments of individual manors or the governments of various primitive tribes) or else relatively ineffective, corrupt, or even merely nominal, as many governments in underdeveloped regions now appear to be.

Political Instability and Guerrilla Warfare

The prevalence of corruption, nepotism, and manifest ineffectiveness in large-scale organizations and especially in governments, both in developing countries today and in the West before the 19th century,[12] is surely consistent with the argument offered here. Evidence from World Bank reports and other sources also confirms that the comprehensive economic planning that developing countries often want usually results at best in a publication, rather than in a series of actions that are in fact implemented. So, too, is the evidence that public services are extremely poor in most developing countries: mail often fails to reach its destination, government schools and universities often do not conduct honest examinations, telephones and electric power systems do not work well, and so on.

[11]See Olson (1973, pp. 355–409). This paper is not as formal as it might be, and a rigorous proof of this contention will be available in a book-length manuscript I am now completing.

[12]See Pollard (1965) on the breathtaking corruption in Britain before the mid-19th century, and Karl Von Vorys (1965) for an example of the limited power of leaders of poor countries. See also Wraith and Simpkins (1974).

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Political instability and the failure of governments to prevent guerrilla warfare also provide evidence for my argument. If governments of poor countries are not effectively administered and the rural areas are governed only nominally, then those who plan a coup are less likely to be caught, and guerrillas have a good chance of operating in the rural areas. The instability of governments in underdeveloped areas is well known, but the striking facts of guerrilla warfare have been overlooked.

Though terrorism of a newsworthy kind has been common, there has not yet been a successful, or even a significant and sustained, guerrilla movement—one that could control and tax significant areas, even temporarily—in a highly developed country, even when the regime imposed upon a people was profoundly repugnant to the subject population. In the relatively developed and urbanized areas conquered by the Nazis in World War II, the subject peoples usually hated the Nazi occupation, which combined political insensitivity with brutality. But despite the depth of this hatred, despite the fact that most of the German Army was fully occupied at the front lines, despite the fact that for much of the war Germany appeared to be a likely loser, despite the outside support available from the Allies, and despite the gallantry of the resistance movements, the Nazis confronted no large-scale guerrilla movements in their occupied territories until the very eve of their departure. Only in backward, rural, and mountainous Yugoslavia were guerrillas able to capture and hold any large areas.

Similarly, the Soviet Union has not been highly regarded by many of the peoples upon whom it has imposed Soviet-style governments. Notwithstanding the resentment revealed by the riots or intervals of free expression in East Germany, Poland, Hungary, and Czechoslovakia, the rebels have not captured any areas from Soviet or satellite troops, or even maintained any sustained guerrilla warfare. The Hungarian insurrection suggested an especially intense resentment of Soviet hegemony, but it was quickly and easily put down by a few divisions of the Red Army. The success of the Nazi and Soviet regimes in controlling conquered nations, despite the hatred and nationalism of the captive peoples, suggests that in highly developed areas it is not possible to overthrow an established and resolute government.

But in other parts of the world, governments are overthrown by internal violence every year. Many of those that have survived cannot suppress the guerrilla warfare within their borders. Guerrilla activity has been sustained for long periods since World War II, not only in colonies or recently created countries such as Algeria, Angola, Burma, Cambodia, Iraq, Kenya, Laos, Malaya, Pakistan, the Philippines, the

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Sudan, Vietnam, and Yemen, but also in relatively established countries such as Afghanistan, China, Colombia, Cuba, Ethiopia, Greece, and Venezuela. Some of these guerrilla wars have persisted against governments that were indigenous and somewhat responsive to their peoples. In Burma, for example, guerrilla warfare has continued for more than 30 years, and for a time nine independent rebel organizations were reportedly engaging in guerrilla warfare in that country. Successful guerrilla warfare has been conducted by anticommunist and conservative forces as well as by Communist or nationalist movements, as when the Yemeni royalists triumphed over the Egyptian and Republican troops supported by Nasser, and presently in Angola and Afghanistan.

Why is it that in some cases the most despised of regimes can silence all opposition, whereas in other cases even relatively responsive governments cannot avoid guerrilla warfare for years on end? If the Soviet Union could subdue Hungary in a matter of days, why could the United States not pacify South Vietnam even over a longer period? It would be morally gratifying to suppose that the explanation is simply that some governments are ruthless and others are gentle. But this could hardly be the whole story. Batista and Diem were anything but gentle, but they could not prevent guerrilla warfare; the French tortured prisoners in Algeria, yet they lost; the American effort in Vietnam took a toll even among women and children, yet the Vietcong and Hanoi ultimately triumphed.

A better explanation of these anomalies is that guerrilla warfare is not feasible in economically advanced nations with established and purposeful governments. Such warfare is, however, often politically profitable in rural areas of economically backward societies. Successful guerrilla movements usually start in the most rural areas and attack the more modern areas only if they have raised a stronger army than the incumbents, or have cut the cities off from reinforcements or supplies. As the Algerian and Vietnamese experiences suggest, the incumbent power, however badly it fares in the rural areas, can hold the large cities indefinitely if it can supply them and is willing and able to maintain a larger army than the rebels can muster.

Some Policy Implications

If the argument in this essay is correct, it follows that the current policies of most international organizations of most countries giving foreign aid are questionable. Most countries giving aid and most international lenders encourage patterns of development that are relatively intensive in large-scale organization, both in the public

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and the private sectors. If large-scale organizational capacity is relatively scarce in developing areas, and it is not feasible or desirable to import this particular input, then this scarcity should affect both the composition of output and the factor proportions used in producing particular products. There is also a greater need for investment in large-scale organizational capacity than is generally recognized. If a crucial factor needed for development is especially scarce, alleviation of this scarcity will be especially valuable. There is a need for better training and exchange programs for managers in both the private and public sectors, more training in accounting and other techniques of administrative oversight for the development of decentralized and self-policing incentive systems, and for better communication and transportation systems.

Most notably, the argument offered here, if it is right, should affect the policies of the developing countries themselves, and in a way that reminds us of Lord Bauer's writings. I have already noted that many people have assumed that the economic theory that emerged in advanced capitalistic countries of the West, showing that markets do allocate resources efficiently, is not applicable to the very different cultures and conditions of developing countries. These countries are allegedly better served by economic planning and protection against imports of industrial goods and against exploitation by multinational companies. Lord Bauer, by contrast, has long emphasized that the underdeveloped countries as well as the developed ones should rely on market mechanisms, both domestically and in international trade.

The general principles that I believe should inspire decisions about the appropriate role for the market and for government in any society are those provided by modern economic theory, which includes the theory of collective choice. Modern economic theory illuminates the circumstances in which markets are the most efficient form of economic organization and also the circumstances in which markets will fail to generate rational results. Some ideologically inspired popularizations of economic theory leave the impression that market failure is relatively rare, if it occurs at all. This impression does not survive a careful scrutiny of either the theoretical or the empirical results: market failure is commonplace, and perfect markets are the exception rather than the rule.

Yet market failure does not necessarily imply that government action would be better: we know from the study of collective choice that governments are also imperfect, and that governments, whatever the institutions and voting rules, will produce optimal allocations only in special circumstances. Those who suppose that, because a market is imperfect, it should be supplanted by government action

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are (as George Stigler has pointed out) like the Roman emperor judging a musical contest with two contestants and who, having heard only the first, gave the prize to the second. In practice, societies must choose between imperfect markets and imperfect governments. Which instrumentality is the better in a particular situation depends on the circumstances: it depends on how badly the market fails and on whether the government at issue will fail to a lesser extent.

This essay has argued that individuals from different cultural backgrounds are broadly similar in response to unambiguous market incentives: behavior in the bazaars and market squares of the developing world is not vastly different from behavior in the markets of the economically advanced nations. Tangible capital and certain kinds of education are rarer in developing countries, which implies that if institutions and government policies are appropriate, these factors of production will fetch a higher price in developing than in developed areas. This relative price will influence not only the pattern of comparative advantage and trade, but also generate a flow of these factors of production as needed to underdeveloped areas. Thus neither shortages of tangible nor human capital need prevent rapid economic development.

Importing large-scale organization in the form of "government" is, by contrast, impossible without imperialism. The poor countries of the world today, like European countries in preindustrial times, are especially lacking in capable large-scale organizations, and especially those bureaucracies that supply public goods effectively over large amounts of territory. The inferior transportation and communication systems and other obvious features of preindustrial countries make effective large-scale organization especially difficult in these societies. These difficulties have made relatively small-scale and unspecialized institutions the norm in these societies. This in turn means that the cultural habits of peoples in preindustrial areas are better suited to small and intimate organizations than to large bureaucracies.

In large bureaucracies, and especially in large bureaucracies providing public goods, the incentives facing individuals are not obvious and clear-cut; behavior depends on what James Coleman has called "the ecology of expectations." Cultural loyalty to institutions such as the extended family and the tribe and the absence of such traditions as that of the "organization man" make governmental bureaucracies work especially badly in most developing countries, and often make them nepotistic kleptocracies as well. These problems often keep governments of developing countries from exercising effective control in rural areas and can even keep them from preventing guerrilla

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warfare in these areas. If these problems were not overwhelming, history would (because of the economies of scale inherent in nonrival public goods) have been largely a succession of universal empires.

Government planning, nationalized industries, and public regulation will, accordingly, usually work less well in developing than in developed countries. Whatever the optimal role of government may be in developed nations, it is smaller in developing countries.

Law and order are needed for economic progress under any system of economic organization. It is evident that at least in rural areas some governments of underdeveloped countries find it difficult to provide even this elemental public service. If a country's full economic potential is to be realized, it must enforce contracts and adjudicate disputes about property rights in impartial and predictable ways. Even in some parts of Europe, such as southern Italy, government has not been able to perform these functions adequately. In some developing countries, even property rights in land are often ambiguous, and squatters, who do not have secure, marketable, and mortgageable rights needed for efficient development, are commonplace. In such circumstances, governments should devote such capacity as they can muster to providing law and order. If they have any effectiveness left over, it should be devoted to the most glaring externalities. Overambitious economic planning and detailed regulation are not likely to be coherently carried out. The wide-ranging governmental intervention that is compatible with high standards of living in some countries of Western Europe should not be expected to work (and has never worked) in any preindustrial society.

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Economic Growth and the Property Rights Regime

Alan Rufus Waters

> It is often nearer the truth to say that capital is created in the process of economic development than that development is a function of capital accumulation.
>
> —P. T. Bauer[1]

Introduction

To those who depended on the assumption that capital accumulation *is* the cause of economic development—Marxists, social engineers, elitists of every ilk, and others—Peter Bauer's words would appear challenging. Indeed the statement is only an example of Bauer's consistent view of economic development. If economic development means anything, it means that the parameters are changing; and the parameters are all those institutional benchmarks that many economists and other social scientists have chosen to hold constant—or at least to let vary with assured prescience (Bauer 1971, pp. 281–82). The real issue involves how capital is selected and how it is subsequently managed. The selection of inappropriate capital and its subsequent mismanagement contributes nothing to development.

There are other and more fundamental forces at work than capital accumulation alone. But those other forces are usually omitted from development models, because if, as Peter Bauer has argued, they are indeed the source of economic progress, we have been on the wrong track in most of the Third World for the past 40 years.

Peter Bauer had to be dismissed as an irrelevant crank because he argued that a free and competitive market with minimal government

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[1]In Bauer and Yamey (1957, p. 127).

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participation would outperform a planned and centrally controlled one. If he were correct—as we now know he was—the role of planners and those who supported interventionist policies would have been sharply diminished. The credibility and prestige of the intellectual establishment of the day also would have been thrown into doubt.

Unquestionably the chivying interventionists were wrong. Cultural and ethnic differences do matter. We cannot ignore the economic success of the overseas Chinese and other immigrant groups. Why is there a taboo against investigating the reasons for their success? Why have they been persecuted, discriminated against, and dispossessed by their host governments?[2] Conspiracies and ethnic factors have only been excuses for their persecution. Could it be that the success of immigrant groups is due instead to a sense of personal responsibility and a consequent high level of entrepreneurial activity?

Are cultural differences fixed? There is too much evidence to the contrary. Rather than using such differences as a reason for further intervention into and manipulation of the economy, we should seek to discover why some groups are so energetic and perform so constructively. This article offers the hypothesis that an important reason for group success can be found in the pattern of ownership and responsibility.

If, within some domestic minority, individual ownership rights predominate, with consequent personal responsibility for success or failure, intervention to restrain the success of that minority is not an appropriate government policy. The appropriate response—insofar as one is required—is to generalize the pattern of ownership rights that made success possible, and to take advantage of its "demonstration effect" to accelerate development for society as a whole. The foregoing argument contains the essence of Peter Bauer's recognition that individuals are the key players in the process of economic development. Individuals, not circumstances, create development.

Before examining the role of the property rights regime in the process of economic growth, it is instructive to consider the meaning of economic success and failure. The fundamental role of ownership and property rights in determining success or failure can then be fruitfully examined.

[2]Would it be indecent also to ask why the World Bank and other agencies have funded expatriates to replace or fill the positions of the domestic Chinese minority in countries such as Malaysia? This is nothing but complicity in the very racism they frequently denounce.

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Economic Success and Failure

It is not enough to ask if individuals in a nation are better off now than they were several decades ago; that should be taken for granted. The past four decades have, after all, seen enormous preoccupation with economic development. Foreign aid and foreign advice have poured into the Third World. There has been an obsessive interest in developing ways to accelerate economic progress. Given these circumstances, it is much more relevant to ask why the less successful nations have not performed better. To raise such a question requires a comparison with an operating alternative and not some abstract ideal. A comparison of South Korea with Sri Lanka is useful.

Twenty-five years ago South Korea was thought to have few recognizable resources, and its capital stock had been destroyed by war. Its per capita income was comparable to that of India, Burma, Sri Lanka, and similar nations, and its Confucian culture was thought unlikely to adapt to modern competitive individualist business methods. Moreover, Korea itself had been sundered some 15 years earlier and the traditional industrial heartland had gone to the communists in the North. Large amounts of foreign aid to South Korea stopped in the 1960s.

Despite these unfavorable circumstances, South Korea has achieved sustained economic growth and is now a middle-income nation. Even with high population density and rapid population growth, it has flourished. The per capita gross national product is now almost eight times that of India, and more than eleven times that of Burma. Life expectancy is now 12 years longer than in either India or Burma.

Sri Lanka and South Korea received their independence at approximately the same time. Sri Lanka inherited from Ceylon a stable administrative structure, established communications and transportation systems, and well-developed educational institutions. Ethnic and religious differences do exist in Sri Lanka, but the fact that almost a third of the people in nominally Confucian Korea were active Christians should not be ignored either.

In 1950 South Korea's gross domestic product per capita was just under 82 percent of Sri Lanka's, in 1963 it was just over 97 percent, and by 1973 it was over 186 percent (Kindleberger and Herrick 1977, p. 17, Table 1–2). By 1983 South Korea's gross national product per capita was over 600 percent of Sri Lanka's (World Bank 1985, pp. 6–9). This incredible divergence cannot be explained by war or external conflict because the victim of such disasters was the country that grew successfully. Foreign aid might be an explanatory factor since Sri Lanka continued to receive increasing amounts of foreign aid

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throughout the whole period, while Korea's receipts declined sharply in the late 1960s (USAID 1982). By this reasoning, however, foreign aid could only be said to have had a pernicious effect on the recipient. It would seem that the examples of nations that have been split into two parts and then operated with radically different economic systems would be the focus of numerous case studies in economic development. This, however, has not been done for North and South Korea, or for East and West Germany. Casual observation, as well as the few statistics from North Korea that can be checked from third sources, leads to the inevitable conclusion that by material and other standards South Korea has far outdistanced its socialist neighbor.

Keith Marsden (1985) has looked at "Why Asia Boomed and Africa Busted." His comparison of the two continents highlighted the fact that countries starting from quite similar circumstances, but following distinctly different policies, have performed very differently in terms of the major development indicators. By the standard of South Korea, most of the Third World has failed.

An impressive range of hypotheses has been offered to explain relative economic failure: vicious cycles of poverty, population density or rapid population growth, cultural factors such as religion, the choice of economic structure, and, always, a lack of capital. Conspiracy theories by structuralists and others abound but do not warrant serious consideration. Foreign aid was, and often still is, the eternal anodyne for every successive failure. By and large, external and exogenous factors have been the principal excuses. Flagrant misgovernment, faulty economic policies, and meddling intervention have only recently begun to be taken seriously as possible sources of economic failure. "A country, whatever its stage of development, can be well or poorly governed. . . . But with the Third World, the notion of responsibility for bad results disappears completely," notes Jean-Francois Revel (1981).

So many elegant technical explanations for failure have turned out to be nothing more than intellectual curiosa. Consider the example of immiserizing growth that once absorbed so much intellectual interest in trade circles, but which, as a practical matter, contributed nothing. There is the unavoidable feeling that many technical arguments about economic progress were similar to the debate about neoclassical growth models and capital theory between the two Cambridges in the 1960s and 1970s—one side trying to destroy capitalism and the other trying to demonstrate its own mathematical virtuosity.

A Return to the Market Mechanism

Ultimately, the best explanation of any phenomenon must be in accord with observed outcomes. The theories that underpinned eco-

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nomic development planning and the role of government as entrepreneur have now had their run. Every success cannot be a special case; every failure cannot be due to random and external events. Economies in the Third World can be grouped into those that are market oriented and those that are more regulated and centrally controlled. The more market-driven economies have consistently outperformed the others.

Markets are back in vogue. There is talk in the Third World, for example, of freeing prices to signal scarcities and surpluses and to allocate rewards. There is even talk of competition as a goad to action in lethargic societies. Privatization is now proclaimed as a viable purgation by governments with distended portfolios seeking relief by eliminating their less defensible activities. We may even yet discover that disguised unemployment can and does exist, but only in the government sector. Finally, James Buchanan (1983) and the public choice school have countered the paradigm of market failure with that of government failure within a democratic setting, pointing out that even imperfect markets may outperform "well-intentioned" government planners. It is now quite usual to see international agencies agreeing with such research conclusions as: "The study finds that rapid economic growth depends on policies, not circumstances" (IMF 1985, p. 61).

The implication of the emerging enthusiasm for markets, however, has not been fully recognized—namely, that the beneficial results of competition and price signals cannot be achieved unless effective ownership rights are established. As Armen Alchian (1967, p. 6) pointed out two decades ago:

> [E]very question of pricing is a question of property rights. . . . [T]he existing system of property rights establishes the system of price determination for the exchange or allocation of scarce resources. Many apparently diverse questions come down to the same element—the structure of property rights over scarce resources. In essence, economics is the study of property rights.

Property Rights

What are property rights and how do they influence economic growth? Property rights are the rights of human beings to control and dispose of property as they see fit. Property rights are human rights over property, as against state ownership and hence detailed rights over humans. Property rights are what people are entitled to do with things they control: who will be allowed to claim the rewards of wise decisions and who will bear the costs of misfortune or irresponsibility.

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To fulfill their role effectively, property rights must be exclusive, transferable, partitionable, and perceived to be permanent. They should be exclusive; the definition of property rights should be clear as to whom the owner may or may not exclude. Exclusion is seldom, if ever, complete. The owner of an automobile may be able to exclude others from using the car without his consent under normal circumstances. In times of war the government may be quite entitled to requisition the vehicle.

Unless property rights are transferable we cannot shift resources from lower- to higher-valued uses. Property rights should be partitionable; it should be possible to divide up the collection of rights that goes with any particular element of property. In this way property may be used economically for a wide range of different purposes under differing circumstances. Rights to mineral resources are the simplest example. The owner of a piece of land may wish to use it for cultivation. At the same time he may wish to allow someone else to pay for the right to search for minerals under the land. This is possible because property rights in the land are partitionable.

Property rights must be perceived to be permanent while belonging to any individual. As Roland McKean has noted: If individuals cannot capture the net benefits they could produce, they cannot be expected to produce those incremental benefits. Or, consider Richard Posner's ([1972] 1975, p. 12) example:

> Imagine a society in which all property rights have been abolished. A farmer plants corn, fertilizes it, and erects scarecrows, but when the corn is ripe his neighbor reaps and sells it. The farmer has no legal remedy against his neighbor's conduct since he owns neither the land that he sowed nor the crop. After a few such incidents the cultivation of land will be abandoned and the society will shift to methods of subsistence (such as hunting) which involve less preparatory investment.

It must be clear that ownership refers to the rights to use assets and resources, and that all such rights are inevitably circumscribed in some way. The right to use one's own mind and body for certain activities is restricted by law. Similarly, the ownership of resources does not carry the right to inflict the results of their use on a neighbor. That also is restricted by law. Nevertheless, the broader the range of rights that are embodied in ownership and the broader the range of opportunities open to the owner, the more valuable the owned resource will be (Alchian and Demsetz 1973).

Because the bundles of ownership rights determine the value of any type of property, it matters little how the property is classified in traditional terms. Property may be tangible or intangible; for exam-

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ple, physical assets or things such as the accumulated goodwill that go with a particular firm or product. It does, however, matter greatly whether property yields pecuniary rewards (money), or nonpecuniary rewards that may have to be consumed in the form of services and other goods.

To capture pecuniary rights the owner of property must be able to sell the stream of services it generates or to capitalize the stream by selling the property itself. Where the rights to sell or capitalize are constrained, by law or by other institutional arrangement, the property value will decline. For example, a government official is delegated the right (and duty) to distribute valuable property such as licenses to buy foreign exchange. The licenses are limited in number as a means to ration scarce foreign exchange. They are, therefore, worth more to the chosen buyers than they cost. Under these circumstances the official has no ownership rights and cannot sell the licenses to the highest bidder (therefore assuring that they go to those who value them most highly). He can, however, transfer part of the value of the licenses to himself in nonpecuniary and inefficient ways—such as distributing licenses to a particular category of people in a manner that would reflect favorably on him within his own social circle. There are many other ways he could accomplish the same end without resorting to legally corrupt behavior. Due to the nature of the property rights that go with the licenses, the official's estimate of their value will be below that estimated by the purchaser. This wedge between the value that the two parties put on the thing being transferred may lead not only to the transfer of nonpecuniary rewards to the official, but also to the possibility of outright corruption.[3]

Another example of the attenuation of property rights can be found in the universal response to rent controls. Where apartment owners are not allowed to charge occupants the full value of their apartments, there has been visible change in the owners' patterns of behavior. Maintenance declines and the number of apartments available for the public is reduced as owners rent to relatives and friends and as they convert their apartments to business or other uncontrolled uses. The effect of rent controls is a partial transfer of property rights from the owners of the buildings to the present group of tenants—with slums being the ultimate result (Furubotn and Pejovich 1972).

[3]The distinction between pecuniary and nonpecuniary rewards stands on the microeconomic argument that pecuniary rewards (money) will always be preferred to nonpecuniary rewards of the same value because money is fungible and tastes differ (Sanchez and Waters 1974).

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Property Rights and Incentives

The pattern of property rights and the cost of marketing those rights will determine what is possible and profitable. If economic growth is the goal, then the structure of property rights should induce people to do those things that lead to economic growth. Economic growth is a long-term process and is more likely to be sustained if people have a strong stake in the future. The way in which ownership is defined determines the expected future income stream from particular kinds of property and thus determines people's vision of the future.

Assurances about future property rights determine both the quantity and kind of wealth people will accumulate. The relative success of South Korea when compared with Sri Lanka may be in large part attributed to the way successive Sri Lankan governments have avowed that their policy was to reduce private property rights in the name of socialism. Until 1977 Sri Lanka's various governments pursued policies that centralized economic power, intervened widely in markets, and moved the country toward a stated goal of complete socialism. Private property was threatened and confiscated, creating an atmosphere of uncertainty about the future. Since few people wanted to acquire or create assets with a low probability of yielding a return in the future, the value of productive assets declined. In the process there occurred a shift from saving to current consumption and a consequent reduction in the overall rate of economic growth. Since 1977, however, Sri Lanka has reversed its economic policies and undertaken a free market approach. Nevertheless, great harm must be undone before Sri Lanka and other such countries become recognizably market-driven, but they have begun (Subasinghe 1986).

Private property rights permit the holder to transfer the results of his efforts to future generations of his choice. This reinforces the family as a social unit. On the other hand, the absence of such well-defined private property rights diminishes the economic importance of the family and reduces the incentive to make provision for the future. In all this is a self-fulfilling prophecy: if the state attenuates private property rights, people will reduce their time horizon and their savings, in turn paving the way for the state to step in with forced saving and government-determined investment.

One way the state can attenuate private property rights is through the tax system. Consider the case of Jamaica. The Jamaican government has chosen an economic system in which people receive free food and other services if they make $1,200 per year. At $1,300 per year they move into an escalating tax structure that reaches a marginal

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rate of almost 58 percent at an income of only $2,500 (Reynolds 1985). Understandably, under this structure the returns on productive activity are very low, and the benefits from remaining in poverty are very high. What kind of wealth could one acquire under these circumstances? As McKean (1964, p. 243) has noted, "[T]he higher the cost of pursuing one objective, the less of it one will try to achieve." We would then anticipate that not only current activities but also the creation of future wealth would take the form of untaxed activities. We might expect, for example, to see emigration as a means to increase the return on intellectual capital in various forms. The net return on illegal activities—after discounting for the risk involved—would increase, and there would be less respect for the law. We might expect to find existing capital poorly cared for and maintained. All of this can be seen in Jamaica, and the effect on economic progress is obvious.

Economic growth means constant and pervasive change. Economic change results in continual re-evaluation of assets in which some people gain and some lose. A strong system of private property rights permits individuals to diversify the inevitable time-related risks by holding a variety of assets. This risk-reducing aspect of property rights can be particularly significant in societies where shifting risks to the government has become an accepted doctrine. Risk is inevitable in economic growth; learning to accept and plan for risk is another key to economic progress. Policies that discourage the emergence of various forms of insurance or the growth of futures markets will retard economic growth.

Restricted ownership of real property—as with land in many less developed countries—will cause a shift to investment in human capital. Schooling and certification will replace other productive activity. However, human capital has several disadvantages in this situation. Human capital normally has a finite life; it deteriorates in later years. It can only be passed on to others at a relatively high cost. If investment in human capital is undertaken voluntarily because the returns are higher than for any other form of property, the outcome will be to the benefit of the individual and society. If, however, people invest in human capital because they are not allowed to invest in other assets, or because the government has subsidized human capital, the benefits to both the individual and society are likely to be overestimated.

It must also be stated that foreign aid has no effect on the structure of property rights and is therefore largely irrelevant from the standpoint of economic growth. Foreign aid may, however, be used to sustain patterns of property rights inimical to economic growth. In

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such cases aid can do substantial harm, as, for example, when it is used to keep alive otherwise failing cooperatives, government farms, and state production and credit institutions.[4] In this respect the World Bank and the international aid donors bear a heavy responsibility for various agricultural credit banks and marketing boards created for the administrative convenience of the lender or donor. World Bank loans to bus companies in Bombay and Tunis, for example, were required to be filtered through additional government institutions when they could have been made directly to the borrower.

Property Rights and Individual Responsibility

Outsiders—both domestic and foreign—have tended to concentrate on the role of positive incentives in the economic growth process. In several less successful societies it is clear, albeit surprising, that almost nobody is personally responsible for anything that goes wrong. Some collective entity is always at fault, and as a result little can be done to correct the situation. Since outside forces caused the problem, the usual recourse is to ask outside forces for help. In more successful societies, on the other hand, there is a sense of personal responsibility. No individual is responsible for every failure that occurs, but people are certainly responsible for those things that they own or have certain rights to use. Herein lies a fundamental aspect of economic growth.

Economists have long ignored the role of negative incentives and penalties in the overall economic learning process. Nevertheless, much of the discussion about capturing externalities is necessarily about the assignment of personal responsibility. Well-defined property rights tie people to the way assets are used. Ownership is an important factor in making people responsible for the outcome of their action or inaction. Furthermore, private ownership ensures in a way like nothing else can that people bear the costs of their actions.

People who own their assets—their intellectual skills or their land—will themselves have to bear the cost of their behavior in terms of the reduced value and productivity of their assets (Shlapentokh 1986). In this sense, with the erosion of the concept of property rights as a natural right, we have lost a great deal. With no personal ownership there is little personal responsibility for what happens, and even less incentive to cooperate with others for mutual benefit. This is the

[4]Peter Bauer's comments on the axiomatic support for subsidized cooperatives are peculiarly appropriate. The cooperative is nothing more than another form of enterprise in which ownership is structured in a way that people seldom choose voluntarily (Bauer 1968).

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basis of the enigma so often observed by foreign visitors to the United States: social cohesion and cooperation among individuals is greater in societies based on individualism than in others based on collectivism. The urge to cooperate is seen formally in the formation of mutual insurance and futures markets. It is more easily seen in the multitude of mutual aid organizations, churches, and social clubs. The tendency to seek shared responsibility and joint protection from risk is important for economic growth, and it is not to be found on the same scale in North Korea or East Germany where ownership (and, therefore, responsibility) lies with the distant and impersonal state.

A free market economy in its operating form is not atomistic or anarchic. There are substantial incentives to cooperation in defining and enforcing limits to the use of private property and to sharing mutual risk. Externalities do exist, but they can frequently be internalized or eliminated through trade and mutually beneficial negotiation among property owners. Since such action would increase the value of each individual's property or it would not be undertaken, people will form cooperative arrangements for various purposes in protection of their property rights.

With private property, be it personal, intellectual, or business, there is a unity of purpose not existing with collective ownership. Self-interest and the profit motive are clear goals. Under these circumstances management is more effective than where property is collectively owned, and there may be a range of often conflicting objectives (Bryce 1960, p. 52). Effective private property rights do not only apply to large blocks of obvious property. The smallest entrepreneur—such as the shoeshine boy on the street in Nairobi—makes economic calculations at the margin and relies for his livelihood on a simple set of property rights and contracts (Elkan, Ryan, and Mukui 1982). It is reasonable to argue that secure private property rights are more valuable to the person who seeks to create wealth than to the existing rich—assuming the marginal unit of wealth is worth more to the person having less to start with. Ownership of trading licenses, permits, and other permissions to operate may be of vital significance to the small trader, as may access to a preferred spot in the marketplace. The way such assets are created and allocated has significant implications for economic growth.

Competition thrives where well-defined property rights exist. These might facilitate trade and create a wider range of owned assets with which to compete. Competition is the engine of economic growth and change for several reasons. It provides clearer criteria for the use of existing resources and drives the continuing search for new

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resources. It propels the search for new and appropriate technologies and ways to do both complex and simple tasks. Finally, it rewards applied research and product development that are patently lacking in less developed countries. Competition also plays a beneficial social role. Since there is no wedge between seller and buyer, competition generates courtesy to and respect for customers and potential customers. In a competitive situation, customers have an alternative, in dealing with government they do not.

The Role of Failure in Economic Progress

I have already argued that private property rights define personal responsibility. Put another way, private property rights specify who may reap the rewards and who must bear the cost of failure. The cost of failure due to misfortune or irresponsible behavior cannot be shifted if property rights are well defined.

The entrepreneur has reemerged as the central figure in economic growth. We still have to overcome the widely held view that entrepreneurs are born with a special talent that cannot be learned or improved upon later. The image is, of course, false. Entrepreneurs learn their skill by interaction with their competitors and with their environment.

Few entrepreneurs succeed at the first attempt. They frequently assert that they have learned more from past failures than from any subsequent success. This message should not be lost on those who seek rapid economic growth. Failure is a necessary part of change, and it is a powerful teacher. Furthermore, there must be failures if an economy is growing and new activities are being introduced. It may be said of the less developed countries that they have avoided many small failures at the cost of some truly national ones. Their rulers do not seem to grasp that failure is a part of success. Nor do they appear to have noticed that a high proportion of all new businesses started in any given year in the United States, for example, will fail.

Given a well-defined system of private property rights, there is little to fear from failure. With sound and flexible bankruptcy laws, administered with due haste and at low cost, failure can be used to great advantage. Bankruptcy does not destroy assets; it releases them from one firm for use in another, and potentially more profitable, venture. Thus, bankruptcy eliminates mistakes quickly and allows new entrants to the business world a chance to seek success. It is in this sense that failure is the basis for ultimate success.

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Because private property rights are partitionable and therefore can be widely held, business failures may appear dramatic; but their collective effect will be offset by their benefits to society. It is the lack of bankruptcy and business failure in the government sectors of the less developed nations that should be of greater concern. The cost to the economy of assets retained in less productive activities may be a luxury that a rich nation can afford; it may be disastrous to a poor country.

Business failures create flexibility for the introduction of new technologies and new institutional arrangements. The financial community can discover a whole new range of potential markets for its services in the process of failure and reconstruction. The lack of this mutual learning experience may be one of the factors causing the slow emergence of organized financial markets in less developed nations.

The Evolution of Property Rights

Much of modern development economics is devoid of institutional content. This is not true, however, of Peter Bauer's work, which is full of forthright demands that attention be paid to the institutional framework. Adam Smith carefully examined the alternatives of public and private ownership under various institutional arrangements (Clarkson 1975). The key to economic growth in this respect is that the institutional arrangements should be easily rearranged so that those that most readily capture new gains and exclude new losses will survive. Private property rights offer the greatest flexibility in this respect.

There is no conflict between the idea of assured ownership rights and flexibility as long as such rights can be freely divided, combined, exchanged, and traded. One of the most important functions for any government is the establishment and monitoring of an evolving legal system that facilitates trade in property rights. On one hand, technology continually changes the nature of property, making some assets more valuable and others less so. On the other hand, technology continually improves the ability to measure and control property so that it may be more effectively traded at lower cost. There is little of this process of evolution in the public sector and even less in those countries committed to socialist ownership (Demsetz 1967).

Additionally, demographic changes are inevitable during economic growth. Private property rights are a more effective adjustment mechanism than any administered scheme for redistribution of wealth. Widespread distribution of tradeable assets permits more flexible

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provision for retirement by individuals than do fixed-age pension schemes. Both the United Kingdom and Chile have recently moved to provide private alternatives to a state monopoly of social security (Goodman 1983). There is every logical reason why this pattern should spread. It would reduce the burden on younger generations who support government pension schemes with their taxes. Also, as the role of women in society changes, a flexible system of private property rights is able to accommodate the acquisition and creation of wealth by new entrants better than any assurance of "public employment." Finally, where property rights have led to the establishment of active markets, there is greater pressure and opportunity for old elites to dispose of their assets and hence make way for new groups in society.

Creating a New Pattern of Property Rights

No nation starts with a clean slate. There is an existing pattern of property rights that is recognized as unsatisfactory by the very search for an alternative. The change from a collective or public ownership to private property rights can be undertaken in two ways. First, all new enterprises must be created on the basis of free and tradeable property rights. Second, the existing system of state enterprises and state ownership must be at least partially dismantled.

At the heart of the process of change must be a reform of the legal system. For economic success, there must be a judiciary that is responsive and evenhanded in adjudicating disputes over matters of contract law. The process of registration, licensing, and other forms of regulation must be streamlined so that all parties can be assured of quick decisions at the lowest possible cost. The appalling cost of overregulation and turgid legal systems is seldom realized. Outsiders rarely come into contact with the full scope of the regulatory and legal systems of Third World nations; the local people are accustomed to their environment and frequently do not realize that it could be improved. The work of Hernando De Soto in Peru, for example, revealed that it can take the equivalent of 289 work days, 81 meters of forms, and 8 overt bribes to legally establish a small clothing factory (O'Shaughnessy 1985). How much further need we go to find a key reason for economic stagnation? The governments of the Third World must undertake legal and regulatory reforms (Bauer and Yamey 1972).

Dismantling the present structure of collective ownership requires an active policy of privatization. Governments are currently producing and distributing goods and services that the private sector could handle more economically if allowed to compete. There is a growing

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body of literature on privatization, and there are numerous historical examples of success.[5]

Privatization can take the form of donation to some existing group such as employees, or sale to the same group or the public. Whatever the method chosen, there will have to be considerable research and substantial involvement of the private sector in every case. Those who control the U.S. Agency for International Development must be given every credit and support for their newly announced policy of specific privatization goals. Their action is eagerly anticipated. This is, perhaps, another indication of the degree to which Peter Bauer's free market principles have prevailed in policy circles.

Conclusion

Private property rights focus individual responsibility for action or inaction. Furthermore, well-defined private property rights permit flexibility in the development process and allow for the rapid emergence of failures as they occur. Finally, private property rights increase the flexibility with which resources can be channeled into more productive activities and to new groups in society. Effective private property rights are essential to long-run economic growth.

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[5]Japan underwent a massive privatization phase during the reconstruction of its economy in the face of financial collapse during the late 1870s (Reishauer 1981, pp. 129ff). Modern examples from the United Kingdom and the United States abound (Pirie 1985; Roth 1985).

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The Role of Property Rights in Development

Gabriel Roth

Alan Rufus Waters (1987) has written a perceptive paper on the importance of property rights in development, a subject ignored by many development economists, though never by Peter Bauer. One result of the neglect of this subject is the naive belief held by some economists that "administrated" prices (that is, prices equated to social costs as determined by the central planners) would enable socialist regimes to work and developing countries to develop. This approach may lead to an improvement in the allocation of existing resources—especially if the alternative is allocation by administrative edict—but, in the absence of clear property rights, is unlikely to stimulate the investment or economic growth found in those societies in which these rights are respected.

The importance of clear property rights may readily be illustrated by the effects of rent controls that reduce the rights of landlords to dispose of their properties in accordance with their own interests. Without exception (so far as I am aware), in every locality in which rent controls have been introduced the result has been the destruction of the market in rented property, with the resulting losses causing particular hardship to low-income landlords and would-be tenants. It is likely that the unavailability of rental housing in Europe inhibits labor mobility and is thus a significant factor in the high unemployment levels prevailing there.

As is to be expected, many blatant examples of losses associated with the lack of property rights are to be found where scarce resources are managed by government agencies. Examples of "government failure" associated with the mismanagement of public utilities abound,

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and not only in developing countries: residents of the Washington, D.C., area need go no further than National Airport to find a plum specimen. But the most widespread example is probably urban traffic congestion, which is generally regarded a "disease of civilization" but which also may be understood as a manifestation of the absence of property rights in urban road space.

Students of economics are taught that traffic congestion is an example of an "externality," whereby each user of the congested facility imposes costs on others for which no direct charge is made. They are also taught that the appropriate remedy is to charge each user the congestion costs imposed on others. Recent developments in solid state electronics now make it technically possible to impose and collect such charges, and the required equipment was recently tested in a pilot study in Hong Kong. But students are rarely taught that private ownership of roads could, at least in theory, bring about a similar result, if competitive road owners were allowed to charge road users profit-maximizing rents for the use of scarce road space. And, while the imposition of such charges could involve considerable technical difficulties, there are no such difficulties to prevent city authorities charging market-clearing rents for the use of parking meter spaces. I know of no city, however, where street parking is charged for at rates designed to ensure that casual parkers are able to find vacant spaces readily at all times in all areas. If the right to charge for street parking were privately owned, it is likely that the turnover at the meters would be maximized, and that society would be better off as a result.

The value of private property is, of course, closely related to the security of its ownership. Few farmers would bother to sow their crops if others had the power to reap them. Therefore, economic development may be expected to be closely related to the existence of "law and order" to protect property rights and thus permit long-term investment. It follows that governments that concentrate on providing goods and services instead of physical security penalize their citizenry not only by misdirecting economic resources through their own agents but also by failing to allow investment to be carried out by those most likely to do it successfully.

The significance of property rights does not appear to be fully appreciated even in the World Bank, which is considered by many to be at the "cutting edge" of development economics. For example, when its officials are asked why the bank does not do more to explore the role of the private sector in development, they respond that the Bank's concern is with "efficiency" and not with "ownership." It must be remembered that a significant number of the Bank's member

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governments—including some of those in greatest need of aid—have yet to be convinced about the desirability of the private ownership of the means of production, distribution, and exchange, and of the best ways to move in that direction.

While it is understandable that World Bank staff like to assist any member government that requests help, some of us doubt the idea that "efficiency" in economic development can be usefully pursued without regard to property rights. Most will agree with Waters that the incentives associated with private ownership of productive capacity will tend to reduce costs and increase output. If a privately owned bus breaks down, the driver is likely to be out of pocket; if a publicly owned one breaks down, the driver may well get a holiday with pay. Which bus is likely to get the better maintenance?

But the more subtle point is that the very meaning of the word "efficiency" becomes unclear outside the context of a market economy, except when used in a mechanical and superficial sense. For example, transportation experts, who rarely use buses, will often tell you that buses are more efficient than cars for transporting people in cities, and that big buses are more efficient than small ones. Yet, in view of the revealed preference of many travelers for the high door-to-door speeds that are usually associated with small vehicles, it may be questioned whether it is possible to assess urban transportation efficiency unless both vehicles and road space are allocated in accordance with market principles. Or, to use another transportation example, some might consider it efficient that minibuses in Kuala Lumpur are so full that they carry standing passengers and make huge profits. But if this capacity shortage is due to the refusal of the authorities to allow additional buses to be provided, maybe it is a misuse of the word to regard the situation as "efficient."

There is a least one staff member of the World Bank who is on record as supporting the role of the private sector in development and as pointing out that this subject is probably the least discussed of all major development issues. I refer, of course, to the Bank's president, A. W. Clausen, and to his speech in London in February 1985. Yet much more remains to be done; rhetoric alone is not sufficient. I am delighted that the U.S. Agency for International Development is doing so much to articulate private sector policies and to present them to the world, as, for example, at the splendid privatization conference held in Washington, D.C., in February 1986.

The Cato Institute is to be congratulated on responding to Clausen's challenge, and Alan Rufus Waters's paper is an illuminating element of this response. I hope that the Bank's new president will use his influence to ensure that more light is shed on this subject,

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and that the World Bank will not only explore the ways in which property rights can spur economic development, but that it also will use its capabilities in information dissemination to make the results of this work readily accessible to officials in all countries.

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Taxation, Economic Growth, and Liberty

Alvin Rabushka

The Third World, often called the less developed countries (LDCs), consists of over 100 nations in Africa, Asia, the Middle East, the Western Hemisphere, and the Mediterranean. Most of these countries are former British, French, or Dutch colonies that received independence after World War II. Although Central and South American countries were long independent, their failure to sustain economic growth consigns them to the category of Third World economies. A few oil-exporting nations enjoy higher per capita incomes than the majority of non-oil exporting countries, but even these select nations recently fell on hard times as world oil prices declined.

Although the British and French bequeathed constitutional democracy to their former colonies, representative institutions proved to be fragile in the Third World. With some exceptions, such as India, Sri Lanka, Malaysia, Costa Rica, and some island mini-states in the Caribbean, many LDCs succumbed to military dictatorships, one-party states, lifetime presidents, extended states of emergency rule or martial law, and totalitarian regimes of the left or the right (though democracy made a strong comeback in Latin America in the mid-1980s). Some authoritarian rulers permitted, indeed encouraged, the development of private enterprise-based market economies; most relied on state planning and control. Few allowed a free press, freedom of speech, and other civil liberties that are constitutionally guaranteed and that flourish in Western democracies.

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Development specialists paid considerably less attention to taxation than such other aspects of development policy as international transfers, central planning, import-substitution schemes, the role of multi-national corporations, and raising expenditure levels. The relationship between taxation and liberty for more than three billion inhabitants of the Third World remains virgin territory.

Taxation and Development: Changing Views

In the early postwar years, Peter Bauer and Basil Yamey (1957) were nearly alone when they warned that taxation could adversely affect economic development:

> It is therefore likely that in many under-developed countries taxation falling on activity in the money sector will reduce the supply of effort to that sector below what it would be otherwise. This reallocation of resources affects adversely total real income. The lower national income and the retardation of the spread of the exchange economy in turn impede long-term growth [p. 199].
>
> The proceeds of compulsory savings are not a simple addition to total saving. It is not even certain that total saving will be increased in the process. Even when savings are increased in the short run, the repercussions of the taxation may reduce the flow of savings in the long run by retarding the spread of the exchange economy and the growth of specialization [pp. 199–200].

Bauer and Yamey also warned that restricting private saving would dampen the supply and effectiveness of local entrepreneurship because state control over savings would be diverted to expand public undertakings.

In contrast, mainstream development economists and such international institutions as the World Bank and the International Monetary Fund generally pushed tax increases, both as an overall share of national income and specifically to "soak" the rich through punitive tariffs on luxury imports, steeply graduated rates of personal income taxation, wealth taxes, and strengthened enforcement. Richard Bird and Oliver Oldman (1975) compiled a representative cross-section of readings on taxation in developing countries. In their introduction to part one, "Fiscal Policy and Economic Development," they refer to an "orthodox" position among development economists: "[M]ost developing countries tax little, and should tax more, particularly through progressive taxes and land taxes."

A cross-section of citations from this literature demonstrates the prevailing intellectual background against which tax planners in LDCs worked:

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- A personal income tax with a narrow base but high rates on large incomes, buttressed by administrative efforts concentrated on this area, may be a suitable instrument for achieving some of the ends of economic policy and distributive justice [Heller 1975, p. 27].
- The shortfall in revenue is thus largely a reflection of failure to tax the wealthier sectors of the community effectively. Though progressive income taxes and inheritance taxes exist on paper in most of the underdeveloped or semideveloped countries—sometimes imposed at high nominal rates, mounting to 80 percent or more on the highest incomes—there are few cases in which such taxes are effective in practice [Kaldor 1975, p. 31].
- Most economists have advocated a development strategy aimed at raising the level of domestic savings through budgetary policy—i.e., reducing personal consumption by increasing taxation. . . . Yet most economists argue for still more taxes. . . . The World Bank attaches importance to increase in tax revenues from country development plans [Please 1975, pp. 39–40].
- Taxation not only can help to bridge the gap between savings and investment but can also be used as one of the instruments for resource allocation, income redistribution, and economic stabilization [United Nations Secretariat 1975, p. 58].
- In taxing foreign income and the income of foreigners, one might latch on to the principle of equality: tax the foreigner the same as the national is taxed; a second starting point might be the principle of charging as tax whatever the traffic will bear: soak the foreigner as much as he will pay without his ceasing to engage in activities the LDC wants him to engage in [Oldman 1975, p. 203].
- The Declaration of Punta del Este, which set up the Alliance for Progress, established as one of its goals: To reform tax laws, demanding more from those who have most . . . to satisfy concerns of equity and meet pressure for more revenues to finance added government responsibilities [Tanzi 1975, p. 233].
- An important economic function of the capital gains tax is to curb speculation . . . and to encourage investments that are economically productive [Amagong 1975, p. 246].
- A net wealth tax, if well designed and effectively administered, can supplement a personal income tax and achieve greater equity in personal taxation [Tanabe 1975, p. 269].
- Owing to the heavy responsibilities that governments are assuming, not only for capital formation, but also for the provision of current services, the underdeveloped countries cannot promote saving merely by maintaining low taxes. Most underdeveloped countries need to raise more revenue, many of them, much more [Goode 1975, p. 273].

The impact of tax rates—especially marginal tax rates—was largely ignored or at least underemphasized, in the traditional development

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literature. Why? In a paper prepared for a 1985 Conference on Taxation and Development sponsored by the U.S. Agency for International Development, Vito Tanzi of the International Monetary Fund answered:

> First, there has been the traditional view that, in developing countries, high incomes do not originate from work effort or entrepreneurship; they are assumed to reflect mostly inherited wealth. Thus, they are more in the nature of rents than of genuine incomes. As a consequence, they could be taxed away with little negative effects. Second, that high incomes inevitably result in high consumption and/or capital flight. Third, that in any case the government can generate a high rate of saving for the country by raising taxes while holding down its own consumption. In this way, whatever negative effect high marginal tax rates might have on the individuals' propensity to save could be more than compensated by higher government saving. Fourth, because of lack of knowhow and entrepreneurship in the private sector, the government had to take the initiative in carrying out investment. The government was seen as the engine of growth in the economy. Fifth, the negative effect on labor supply could be ignored because of the overabundance of labor. Some influential studies assumed that the supply of labor schedule was perfectly elastic at a subsistence level of wages. Sixth, that private investment in desirable sectors could be stimulated through the use of specific tax incentives, so that low tax rates on corporate income were not necessary. Seventh, that in any case there was little *solid* evidence that marginal tax rates were important in determining the propensity to save, invest, or to supply greater effort [pp. 1–2].

Although all development economists did not share these assumptions, Tanzi notes that many of the assumptions were prevalent throughout much of the literature on economic development and taxation until recent years. How did they prove to be faulty? According to Tanzi (1985, pp. 2–4):

> First, in developing countries, large incomes are often more the result of . . . implicit taxes, than of property ownership. In many developing societies today it is more important to have access to subsidized credit, to scarce foreign exchange at official exchange rates, to import licenses, or to be able to produce behind a protective wall than to own property. . . . Rents based on government policies have replaced rents based on property ownership.
>
> Second, the assumption that high income inevitably results in high consumption has been challenged in various theories of the consumption function. Some of these challenges are as relevant for developing countries as they are for industrial countries.
>
> Third, . . . in many countries the increase in the tax burden that took place over the years did not result in higher public saving, as had been anticipated, but in higher public consumption. Further-

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> more, whatever public investment did take place, it was often misallocated resulting in very low or negative rates of return.
>
> Fourth, . . . the government does not have a monopoly over know-how or entrepreneurship. A country without entrepreneurs in the private sector is not going to produce them in the public sector.
>
> Fifth, it has been recognized that even though the overall labor supply may be abundant . . . it is rarely abundant for particular skills.
>
> Sixth, the argument on whether one can stimulate more investment by low corporate tax rates or by investment incentives is still a debatable one.
>
> Finally, while in the past it was often argued that there was no evidence that high marginal tax rates had any effects on the propensity to save, invest, and work harder, in recent years more and more studies using sophisticated techniques have shown that taxation may in fact have some negative effects.

This changed worldview is reflected in recent publications by Keith Marsden and Chad Leechor of the Industry Department of the World Bank. Marsden (1983) argued that on the basis of a sample of 21 countries in the Americas, Asia, Africa, and Europe, countries that imposed a lower effective tax burden on their populations achieved substantially higher real growth than did their more highly taxed counterparts. Marsden (1985) later specifically examined 17 LDCs in Asia and Africa and concluded that low tax rates stimulated economic incentives and economic growth in the high and medium growth economies.

Leechor (1986) contended that tax policy influences private saving and capital formation and that tax increases often shrink the tax base or foster tax evasion and damage the private sector. Instead, tax policy should aim at improving incentives. Based on a comparative study of Colombia, Korea, Mexico, and Thailand, Leechor recommended reducing marginal tax rates, broadening the tax base, exempting savings from the tax base, indexing the tax system against inflation, restructuring corporate taxes by permitting expensing of investment costs in the first year, and granting exporters full tax rebates and duty drawbacks on purchased inputs.

Despite the recent transformation in thinking that Tanzi summarized and that Marsden and Leechor illustrate, the old views have not yet been fully rejected by both scholars and policymakers in LDCs. It is still common to find countries with marginal income tax rates of 70, 80, or 90 percent that take effect at relatively low incomes (by industrialized nation standards). Even though these top marginal tax rate thresholds represent several multiples of per capita gross domestic product (GDP) in LDCs, multiples of per capita GDP do not determine incentives to work, save, or invest. Individuals with

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entrepreneurial talent, specialized skills, or capital are generally aware of the better opportunities that exist in other countries; and it is critical for developing nations to retain these talented people. The loss of this minority of potential entrepreneurs, scientists, engineers, professionals, and skilled laborers could grind the entire process of development to a screeching halt. High marginal tax rates that affect a small minority of the population and supply less than one-tenth of total revenue in many LDCs could have severe repercussions on economic growth. People and human capital are no less internationally tradeable and transferable than are commodities and capital.

Some development analysts believe that the emphasis marginal tax rates receive in current thinking about fiscal policy and incentives for growth is misplaced. Even if marginal tax rates are important in the development process, these analysts contend that income taxes are insignificant compared with the wide range of other government policies that discourage growth. These forms of "implicit taxes" also deny people a rate of return on work, saving, or investment that is effectively equivalent to a tax levied on a market rate of return. In some LDCs, implicit taxes overwhelm the impact of the statutory tax system on levels of economic activity.

The statutory tax system, however, serves as something of a proxy for a range of government policies. For purposes of analysis, it is easier to obtain quantitative data on taxation than on such other governmental interferences with the market as overvalued exchange rates, farmgate prices, and minimum wages. There are almost no data on many of these important factors—at least none that are available to researchers. But a variety of government agencies and commercial firms publish data on statutory tax systems, and the IMF publishes substantial figures on aggregate levels of taxation.

Principles of Taxation for Developing Countries

An ideal tax system should meet five practical requirements that foster a climate of growth. First, sufficient revenue should be generated to finance a major part of overall public expenditure—to pay for the limited, legitimate activities of government—and maintain fiscal reserves at a satisfactory level.

Second, the tax system should remain neutral toward the internal cost/price structure, the supply of human effort, and private investment decisions. This means, in effect, that the emphasis should be on proportionality apart from a modest degree of progressivity on personal taxation to leave the poorest classes untouched by direct taxation.

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Third, the laws governing the tax system should be revised from time to time to make them consistent with changing commercial practices.

Fourth, each and every levy—direct or indirect—should be simple and easy (and, therefore, inexpensive) to administer and not encourage evasion.

Fifth, the tax system should be only exceptionally used to achieve nonfiscal objectives. Such policy objectives should be pursued directly through public expenditure programs and by appropriate legislative measures, not indirectly by adjustments to tax rates and amendments to tax laws. Once a government starts to use the tax system to pursue economic and social policies, the consequences are unpredictable and usually irreversible and the costs are unquantifiable.

Taxation, Growth, and Liberty

Analysts of American and European taxation enjoy access to a wealth of generally reliable data on national income accounts, tax systems, and other aggregate economic indicators. Analysts of LDCs are less advantaged; they have to patch together often incomplete, unreliable, or downright inaccurate data from a variety of private and public international sources. The most helpful and most frequently consulted sources are "World Development Indicators," published annually by the World Bank, and "Government Finance Statistics" and "International Financial Statistics," published monthly and annually by the International Monetary Fund. The IMF also publishes an annual "Supplement on Economic Indicators." But mixing and matching these sources into a unified data file is not an entirely straightforward process. The IMF roster of developing countries numbers 104, but World Bank indicators are available for only 98. The gap of six is compounded by some non-overlapping; the British Crown Colony of Hong Kong, for example, is not a member of the IMF and its financial statistics are not published in IMF bulletins, whereas Hong Kong's development indicators appear in World Bank publications. Only a few basic indicators appear in World Bank tables for small countries with populations under one million.

This picture overdramatizes the availability of data on LDCs. Among the 104 LDCs for which the IMF publishes financial statistics, complete national income accounts exist for only 57. Partial GDP information is published in the "Supplement on Economic Indicators" for 95 LDCs, but the accuracy of many of these numbers are suspect.[1]

[1]Kuwait, Oman, and the United Arab Emirates were eliminated from the data file because all receipts are derived from oil exports and their various high-score devel-

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The percentage of public receipts collected in the different forms of taxation is available for 104 LDCs. The timing of IMF financial statistics ranges from as recent as 1984 to as far back as 1978 or 1979 for some countries. Many African nations have been slow to get their financial statistical houses in order.

Neither the World Bank nor the IMF release detailed information on the structures of their member countries' tax systems. Details on the rates of direct and indirect taxation, what is and is not taxed, along with exemptions, deductions, credits, special incentives, and other features of taxation, must be culled from other sources. For information dating from 1975, the most readily accessible data appear in the publications of two commercial international tax service organizations. Beginning in 1975, Price Waterhouse has published the structure of tax rates and tax brackets for individual income taxes in those countries, numbering 94 in 1985, in which it maintains offices. Since 1982, Coopers and Lybrand has published a competitive volume. When colonies and dependent territories are excluded from the two firms' joint listing of 104 separate taxing entities, only 77 countries remain, some of which are mini-states of little consequence. Several of the 77 are oil-exporting nations that rely solely on oil proceeds for revenue.

The best source of tax data before 1975 is an annual series published between 1958 and 1973 by Great Britain's Inland Revenue Department. The series contains annual tax specifics for approximately 40 countries between 1958 and 1973. The early volumes were titled *Income Taxes in the Commonwealth* and *Income Taxes Outside the Commonwealth* (1958–66); the successor series combined both into one annual volume titled *Income Taxes Outside the United Kingdom* (1966–73). Comparable data on overseas French and Dutch territories are not readily available, nor are data on Latin American nations before 1975. To assemble these data requires the scrutiny of legislation on a country-by-country basis, which no clearinghouse has yet assembled on a historical basis. The International Bureau of Fiscal Documentation in Amsterdam publishes current information on explicit taxes for all regions of the world and maintains an extensive library, but its historical collections are sporadic and incomplete. As a result, attempts to link indicators of economic performance to long-run changes in effective marginal tax rates on individuals and effective tax rates on businesses, industries, and economic sectors

opment indicators are due solely to the interplay of high oil receipts and small populations. These three cases constituted serious outlyers and were removed to eliminate unnecessary distortion in the analysis.

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cannot encompass the entire developing world and are severely restricted by the paucity of longitudinal data to the most recent decade (1975–85).

More data are available for economically important and heavily populated countries than for extremely poor, economically unimportant, lightly populated LDCs. Neither Price Waterhouse nor Coopers and Lybrand maintain an overseas office or local correspondent in those developing countries with the least attractive business opportunities.

Few scholars have attempted to link tax policies and other indicators of economic performance with measures of political and civil rights. If sustained economic growth has no effect on the evolution of democratic institutions or civil liberties or if overly rapid growth engenders totalitarian regimes that repress individual freedom, then stressing growth policies would require serious reconsideration. On the other hand, if a necessary condition of democracy and improving individual liberties was high growth, policies that fostered prosperity would also nurture free institutions and individual rights.

Data on political freedoms, civil rights, and democratic institutions are routinely published in the annual January-February issue of *Freedom House,* which allows us to assess the relationship between economic performance and several measures of political and economic liberties. *Freedom House* ranks virtually all nations by civil liberties and political rights on a seven-point scale from "most free" (a score of 1) to "partly free" (3–5) to "not free" (a score of 7). Political rights range from the presence of a fully competitive electoral process to a limited role for opposition parties within a predominantly one-party state to the complete absence of free elections where despots rule unconstrained by public opinion or popular tradition. Civil liberties encompass freedom of the press, court protection of the individual, free expression of personal opinion, and free choice in occupation, education, religion, residence, and so on, to the other extreme of pervading fear, little independent expression even in private, and swift imprisonment and execution by a police-state.

A complete analysis of developing countries, therefore, should encompass both economic and political dimensions. Economic development takes place within a sovereign political entity that maintains specific institutions of government that permit or suppress political freedoms and civil liberties. It is important to know whether growth, the chief indicator of development, is correlated with the spread of democratic institutions and individual freedoms.

A fully specified model linking important economic and political variables with growth cannot be tested because extant data excludes

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potentially important factors. Available data include such standard measures as tax shares of gross national product; the composition of taxes; top marginal rates and thresholds of the individual income tax; long-term annual average changes in exports, imports, investment, public and private consumption, industrial and agricultural output, public and external debt, and several political indicators. Data on implicit taxes that affect growth and development, however, are even more difficult to obtain than evidence on changing tax rates over time. Precise, statistical information on farm-gate prices is available only on a sporadic, case-by-case basis. Another crucial implicit tax on exporters (and subsidy for importers) is exchange-rate overvaluation, for which quantitative estimates may be available only in the confidential files of the IMF. The World Bank's preliminary study of exchange rate distortions for 31 countries shows only 12 with medium or high distortions, which limits the ability to include these data in analyses encompassing between 50 and 100 developing countries.

There are two other potentially important variables: (1) the extent to which the tax laws are enforced (compliance) and (2) the extent to which the presence of an underground economy vitiates the disincentive effects of statutory systems of taxation. Data on these variables are virtually nonexistent. Indeed, the overriding difficulty in analyzing taxation and development is the lack of data by which hypotheses can be tested. An important aspect of future work must be the extent to which one counterproductive dimension in a tax code is a proxy for an entire system of explicit and implicit taxation that retards growth.

Findings

Analysis reveals that *rates of taxation are more important than overall tax burdens in affecting growth in LDCs.* For 49 LDCs, countries with higher incomes have somewhat higher levels of aggregate taxation; the simple correlation of taxation as a share of GNP with the prior 22 years of average annual economic growth rate (on a per capita basis) is a relatively modest .274 (significance = .028). High growth countries, which became prosperous, have relatively larger aggregate tax burdens than slow growth countries; their economies are based more on industry than on agriculture. As these countries prospered, their governments took away a higher percentage of national income in taxes, which is what happened in Western industrial democracies. But larger aggregate tax burdens in LDCs do not necessarily reflect higher rates of tax on individuals, corporations, and commodities. For example, Hong Kong's aggregate tax burden

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is higher than that found in many LDCs, even though its tax *rates* are the lowest.

The overall level of taxation in 49 LDCs is not significantly linked with high or low rankings on political or civil liberties.

When the analysis is shifted from aggregate tax levels to the composition of taxes, the universe of LDCs expands to over 100, reflecting more abundant data. Greater dependence on direct taxes (individual income taxes, corporate taxes, social insurance contributions, and property taxes) is positively related to overall economic growth, the growth of private consumption, per capita income, and the level of public spending. Rich, high-growth countries collect a higher share of receipts in the form of direct taxes than do poor countries. They have developed an urbanized, industrial, commercial economy on which direct taxes can be imposed (though, as shown later, tax rates matter significantly).

As dependence on indirect taxes rises, countries fare less well in their annual growth rates of imports, investment, industry, overall economic growth, and, consequently, private consumption and per capita income. Most of this adverse effect is due to the application of international trade taxes, not domestic excises or sales taxes. Most LDCs depend heavily on exports and imports; the correlation between per capita income and international trade taxes, for example, is -.415. Over-reliance on indirect taxes may retard export-led growth from either the industrial or agricultural sector.

To the extent that the system of taxation and the structures of tax rates influence economic growth, taxation indirectly affects the prospects for individual liberty in LDCs. The relationship between annual average rates of economic growth over 22 years and the scale score for political rights and civil liberties shows that countries with negative growth have very poor scores on individual rights. But once economic growth exceeds 3 percent, political and civil rights scores significantly improve. In particular, I found that for 93 LDCs on which both growth and freedom measures exist, countries with sustained low growth show negative ratings on political rights and civil liberties; high-growth countries show a more encouraging distribution. High growth may not be a sufficient condition of individual liberties, but it appears to be a necessary condition for the gradual emergence of political and civil rights.

Furthermore, countries with low per capita incomes, the result of decades of no growth to slow growth (not necessarily low starting points, since even the high-growth Pacific Rim economies began their postwar ascent with per capita incomes of below $200), fare badly on political rights and civil liberties. Twenty-five countries

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had per capita GNP figures below US$400 at the end of 1982. Of these, only six received a score of 1–4 on political rights and four received a score of 1–4 on civil liberties. Fewer still earned scores of 1–3. In contrast, 19 of 25 received dreadful ratings on political rights and 16 received equally dismal ratings on civil liberties. The leaders of the economic basket cases of the world inflict the greatest political deprivations on their subjects.[2]

Tax Rates and Economic Growth

The link between tax rates and development is revealed in Table 1, which groups countries by top marginal rates and the brackets at which the top rate applies in that country. I have subdivided countries into nine working classifications, based on a high, medium, or low top marginal rate, and whether the top rate applies at high, medium, or low thresholds of income. Only one country, Hong Kong, maintained a low top marginal tax rate. Hong Kong also enjoyed the highest growth rate in per capita income. In general, countries with high thresholds turned in consistently higher growth than those with low thresholds. For medium tax rate, high threshold countries, the average was 4.5 percent; for high tax rate, high threshold countries, the average was 3.9 percent. Even the high rate, medium threshold countries averaged 3.1 percent.

This point is worth belaboring. So long as high top marginal rates do not bite at low levels of income, they do not inhibit human endeavor on a wide scale. No individual is deterred from moving out of the subsistence sector into the cash economy by the disincentive of high marginal rates of tax on low cash incomes. The effective marginal tax rate remains low for the overwhelming majority of the economically active population. Even at the medium threshold, between $20,000 and $50,000, most taxpayers face effective low rates. It is the low threshold countries, where the top marginal rates take hold at very low incomes for professional, skilled, mobile, middle- and upper-middle-class populations, that show the worst performance. Even if only a small proportion of a country's population is caught in the income tax net, that small fraction is the human engine that drives growth through decisions to invest, work, save, or shift money and human capital abroad and substitute leisure for effort.

Like commodities and capital, people can be viewed as internationally tradeable or transferable. Individuals export their talents as

[2]Tables showing the long-run relationship between economic growth and civil and political liberties, as well as the relationship between per capita income and freedom, for selected LDCs, are available from the author upon request.

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well as their capital. For those residents of developing countries who possess highly valued skills that are in demand in other countries, they may be tempted to migrate to earn higher after-tax returns on their human capital. Therefore, to view the earnings of this small, but important, minority who provides entrepreneurial, technical, professional, and other skills and services as a multiple of per capita income in their own countries is potentially misleading as an indicator of this group's economic well-being and incentives. Even if a Pakistani, Indian, Jamaican, Briton, or other foreign resident enjoys a relatively high income in his own country, he may still migrate to another country in which the application of his skills or talent provides a sharply higher after-tax real income and, equally important, a lower top marginal rate on incremental units of output.

Bangladesh, Ghana, Jamaica, and several East African nations show especially dismal economic performances. The high rate, low threshold average for 21 countries is 1.9 percent, and this grouping includes many of the economic basket cases of the world. *Even moderate top marginal rates that bite at relatively low incomes cripple growth.*

It is possible to refine each of these categories. When the last category is recalculated to include only those countries with thresholds below $10,000, or whose marginal tax rates exceed 70 percent when the threshold falls between $10,000 and $20,000, the average growth rate of this subgroup of 14 nations was only 0.8 percent. Of the 14, 4 had negative growth and only 3 displayed average annual growth rates of over 2 percent.

Overall, per capita income for 63 developing countries is negatively correlated with high marginal tax rates ($r = -.443$; significance = .000). (This relationship is much stronger than that reported earlier for aggregate tax burdens and growth.) The poorest countries of the world consistently maintain systems of individual income taxes with the highest marginal rates. A similar pattern holds for per capita income and tax thresholds for the top rate: lower thresholds go hand-in-hand with smaller per capita incomes ($r = .26$; significance = .026).

Finally, higher top marginal tax rates correlate negatively with the size of the budget surplus/deficit as a percentage of gross national product. To be specific, countries with lower rates tend toward balanced budgets or modest deficits; countries with higher rates tend to run the largest deficits. High tax rates do not foster balanced budgets, and raising tax rates to further reduce deficits seems counterproductive.

A cursory examination of corporate tax rates shows a large measure of uniformity throughout the developing world. I could find no statistically significant patterns relating corporate tax rates with per

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TABLE 1

MARGINAL TAX RATES AND AVERAGE ANNUAL ECONOMIC GROWTH IN LDCs, 1960–82

Country by Tax Rates and Thresholds	Marginal Tax Rates (%)	Tax Thresholds ($)	Economic Growth Rate (%)	Mean Growth per Tax Group (%)
Low Tax Rates—All Thresholds	0–24	All		7.0
Hong Kong			7.0	
Medium Tax Rates—Low & Medium Thresholds	25–49	0–50,000		2.1
Argentina			1.6	
Bolivia			1.7	
Ivory Coast			2.1	
Paraguay			3.7	
Solomon Islands			1.3	
Medium Tax Rates—High Thresholds	25–49	50,001+		4.5
Indonesia			4.2	
Singapore			7.4	
Venezuela			1.9	
High Tax Rates—Medium Thresholds	50+	20,001–50,000		3.1
Belize			3.4	
Botswana			6.8	
Brazil			4.8	
Cyprus			5.9	
Dominica			−0.8	
Malaysia			4.3	
Morocco			2.6	
Nigeria			3.3	
Philippines			2.8	
Senegal			0.0	
South Africa			2.1	
Trinidad & Tobago			3.1	
Zimbabwe			1.5	

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High Tax Rates—High Thresholds	50+	50,001+		3.9
Dominican Republic			3.2	
Ecuador			4.8	
Egypt			3.6	
Korea			6.6	
Liberia			0.9	
Mexico			3.7	
Nicaragua			0.2	
Panama			3.4	
Taiwan			7.0	
Thailand			4.5	
Tunisia			4.7	
High Tax Rates—Low Thresholds	50+	0–20,000		1.9
Bangladesh			0.3	
Barbados			4.5	
Chile			0.6	
Costa Rica			2.8	
Fiji			3.2	
Ghana			−1.3	
India			1.3	
Jamaica			0.7	
Kenya			2.8	
Malawi			2.6	
Malta			8.0	
Pakistan			2.8	
St. Lucia			3.4	
St. Vincent			0.6	
Sudan			−0.4	
Swaziland			4.2	
Tanzania			1.9	
Turkey			3.4	
Uganda			−1.1	
Zaire			−0.3	
Zambia			−0.1	

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capita income, economic growth, macroeconomic trends, or political variables. A more complete analysis of the effect of corporate taxes on development would have to take into account depreciation schedules, investment credits, provisions for special deductions against foreign exchange losses, bad debts, and so forth. Given the widespread variability of these factors affecting actual corporate tax liabilities, it is somewhat surprising that statutory rates are so uniform.

Apart from the overall rate of economic growth, other indicators of macroeconomic performance did not emerge as significantly correlated with political rights or civil liberties. High-growth, high-income nations are more likely to evolve competitive party, democratic systems of government. Democracies, of course, are more respectful of political freedoms and civil liberties. Growth, which leads to rising prosperity, is a necessary but not sufficient condition of democratic institutions and individual freedoms. *Stagnation, which breeds poverty, is almost a sufficient condition for authoritarian governments, political repression, and the denial of civil liberties.* A humanist view of the developing world dictates the application of low tax rate, growth-oriented economic policies.

Postwar Trends in Individual Income Taxes

The importance of the personal income tax varies among LDCs, but reactions to using the tax to achieve income redistribution and other political objectives reflect an overall attitude about economic and fiscal policy in general.

Economists readily agree that low tax rates introduce minimal distortions into an economy. High tax rates, on the other hand, seriously distort allocative decisions and erode incentives to work, save, and invest. Individual income taxes contribute varying shares of total revenue in developing countries. Excluding the oil-exporting countries, 23 countries in Africa receive less than 10 percent of total revenue from individual income taxes, 11 from 10–20 percent, and only Liberia, South Africa, and Zimbabwe collect over 20 percent. In Asia, the individual income tax is a more significant source of revenue: 4 countries collect less than 10 percent, 5 collect from 10-20 percent, and 2 more than 20 percent. Outside Israel, virtually no Middle Eastern country depends on the individual income tax. Among developing countries in the Western Hemisphere, the highest take is 17.5 percent. For IMF-reported data, 10 countries collect less than 10 percent and 10 collect from 10 to 17.5 percent. These relatively small proportions are often compared with the industrial countries

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in which individual income taxes range from as low as 8.4 percent to as high as 57.2 percent, with the average running well over 20 percent.

Because of these figures, many analysts of LDCs are concerned that attempts to link the structure of marginal tax rates and the income tax base with the determinants of economic growth are misdirected. But the economic damage caused by a tax that raises little revenue can be substantial. For example, a 100 percent tax on any import may raise little or no revenue, but it could completely retard an industry that depends on imported inputs. High import duties also foster smuggling. Similarly, high export taxes on agricultural goods collect little revenue, yet they discourage commercial production in favor of subsistence agriculture. A system of high marginal tax rates may raise little revenue, yet prevent the emergence of equity markets, discourage prospective entrepreneurs, drive people into the underground economy, foster tax shelters, and so on. Thus, any system of high tax rates has the potential to wreak economic havoc far out of proportion to any revenue it generates and any social objectives it is designed to attain.

Table 1, which clusters countries by the level of top marginal rate and the threshold at which the top rate takes hold, suggests that sound, growth-oriented policies cohere in packages. The low top rate/high threshold countries racked up consistently higher average growth rates than did countries with high rates or low thresholds or both.

In the appendix to this paper are plots of the annual changes in top marginal tax rates and thresholds for selected developing countries. Depending on the availability of data, the periods plotted for some countries encompass 1956–85; others include only the years 1963–85, 1974–85, or 1979–85. The ready availability of tax information published by Great Britain's Inland Revenue Department on British commonwealth countries permits 30-year trend lines to be drawn for those countries. The combined commercial reports of Price Waterhouse and Coopers and Lybrand omit tax information for 1975, 1977, 1978, 1980, and 1983. Missing data appear in the trend lines as dots connecting reported observations.

The graphs illustrate three radically different experiences with developing country policy toward the individual income tax. Four countries (Hong Kong, India since 1974, Indonesia, and Singapore) show a commitment to supply-side, low marginal tax rate policies. One (the Philippines) briefly attempted marginal rate reductions with little success. The remaining countries show excessive concern with equity, "soaking the rich," and a general disregard for the adverse effects of eroding incentives due to high tax rates.

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The British Crown Colony of Hong Kong is the quintessential neutral, low-tax, supply-side revenue system (Rabushka 1976, 1979). Throughout its entire postwar development, public officials emphasized the need for low, stable tax rates and preventing inflation from pushing taxpayers into higher brackets by adjusting, when necessary, the thresholds on which tax rates are applied. Hong Kong's low tax system goes hand-in-hand with budgetary balance, free trade, sound money, and reasonable regulatory requirements.

Singapore also enjoyed high rates of growth for several decades. Shortly after independence, Singapore's leaders stretched the top rate from 30 to 55 percent by 1961 on taxable income exceeding US$30,000. Because per capita income in Singapore was below US$1,000, only a handful of the population paid high rates. But Singapore's leaders remained conscious of the disincentive effects that would confront its citizens as growth pushed the middle class into high tax brackets. Accordingly, they raised the threshold for the top rate from US$30,000 in 1970 to beyond US$100,000 by 1977. Moreover, in 1979 the government announced a series of rate reductions that slashed the top individual rate to 40 percent in 1985. In 1986, employer contributions to social insurance taxes were also reduced. With per capita income of $6,800 in 1985, most taxpaying Singaporeans face an effective tax rate (disregarding personal allowances) of 10 percent. Even millionaires get to keep 60 cents of each additional dollar.

The graphs that display changing thresholds in nominal U.S. dollars do not take inflation into account. Between 1967 and 1984, the domestic price level in the United States tripled. If thresholds were expressed in constant dollars, $10,000 in income in 1967 would represent the same purchasing power as $30,000 in 1984. A falling threshold trend line expressed in nominal or current dollars thus grossly understates the true extent of bracket creep. It would be necessary to triple thresholds between 1967 and 1984 to reflect changes in the price level. A modest upward trend line may not fully offset the effect of inflation on purchasing power.

Take the case of India. The first phase of tax policy consisted of increases in the top marginal rate from 73.5 percent to an incredible 97.75 percent in 1973. Through 1969, the government partly offset the effects of higher rates by raising the threshold from approximately $14,000 to $33,000. But as tax rates peaked, the threshold was slashed to a mere $7,500, thus exposing greater numbers of Indians to the top rate. The final phase of income tax policy consisted of maintaining a relatively constant threshold in nominal terms (thus falling in real terms), while systematically reducing the top marginal rate of tax. A

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declining threshold offset some beneficial effects of lowering the top rate. With Rajiv Gandhi's ascent to power, India successfully installed supply-side tax-rate reductions, and the Bombay stock exchange boomed through 1985 and early 1986.

Since 1979, Indonesia undertook a concerted effort to inject incentives into its economy, minimize tax avoidance and evasion, and reduce dependence on oil receipts in the face of declining oil prices. Indonesia reduced its top marginal rate from 50 to 35 percent and raised the threshold from US$15,000 to US$50,000. Receipts from the income tax rose in 1985, both in absolute terms and as a share of total revenue. Cutting tax rates and increasing thresholds had a positive effect on revenue collected from the income tax, and economic growth was a healthy 4.5 percent in 1984. These results were especially important to Indonesian planners during the oil price decline in 1986.

The Importance of Threshold

The Philippines illustrates wild swings in fiscal policy. During the early 1970s, a top marginal rate of 55 percent applied to taxable incomes exceeding US$90,000. By 1979, the government raised the top rate to a prohibitive 70 percent and at the same time cut the threshold to $60,000. Recognizing that these trend lines were counterproductive of efficiency and revenue, fiscal authorities cut the top rate to 35 percent in 1982. Any efficiency gains that might have ensued were suppressed by the international recession that affected the Philippines and its trading partners. In addition, a portion of the supply-side gains was dissipated by the sharp decline in the threshold. By 1985, the worst of both trends materialized: the top marginal rate stood at 60 percent and the threshold fell to $25,000.

Anti-Growth Tax Systems

The socialist revolution in Portugal was accompanied by a dramatic transformation of the individual income tax system. The new rulers raised the top marginal tax rate of 45 percent in 1969 to 90 percent by 1976; they rolled it back slightly to the mid-1970s by 1984. In addition, they reduced the threshold from over $100,000 in 1969 to $20,000 in 1979. The middle classes faced confiscatory rates of personal taxation on modest levels of taxable income.

Four countries in the Western Hemisphere have the same pattern: Brazil, Chile, Jamaica, and St. Vincent. The top marginal tax rate in Brazil rose from 50 to 60 percent at the same time that its threshold declined by nearly two-thirds, from $76,000 to $28,000. Chilean

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authorities lowered their statutory top rate from 70 to 55 percent, but domestic inflation and currency depreciation eroded the applicable threshold from a high exceeding $100,000 in 1975 to a meager $3,000 by 1984. The entire economically active population faced the top marginal tax rate—a flat tax of 55 percent—on almost all taxable income.

Through virtually its entire post-independence era, Jamaicans faced a top, stiff tax rate of 75 percent, ranging as high as 80 to as low as 57.5 percent since 1981. As the lower rates came into effect during the 1980s, the threshold collapsed from a comfortable $20,000, which excluded the overwhelming majority of the population, to a low of $2,800. Small wonder that Jamaica exports talented people. Any skilled or successful individual faced an effective flat-rate tax of 57.5 percent on all taxable earnings beyond the first $2,800. Jamaica recently announced changes in its tax system that sharply lower marginal tax rates.

The final example in the Western Hemisphere, the Caribbean island of St. Vincent, recorded a paltry annual average growth rate in per capita income of below 1 percent since 1960. Although the country's leaders reduced the top rate from 65 to 55 percent in 1981, they let the threshold slip from $8,700 to $3,700, thus providing an incentive for talented people to migrate.

African countries especially demonstrate the twin effects of rising rates and declining thresholds; the continent also turned in the poorest record of economic growth among developing countries. Almost every negative growth country is located in sub-Saharan Africa; the most distressed are Ghana, the Sudan, Uganda, Zaire, and Zambia. Other disappointments include Kenya and Malawi (with growth rates of under 3 percent), and Tanzania (below 2 percent). These figures do not compare favorably with annual average increases in per capita income of 7 percent in Hong Kong, Taiwan, Korea, and Singapore.

By now the story is straightforward. Inflation pushed the entire Ghanaian nation into the top 60 percent bracket on incomes exceeding $450; Sudanese pay a top rate of 70 percent at a threshold that declined from $30,000 to $10,000; Ugandan taxpayers confront marginal rates of 70 percent on taxable incomes exceeding $4,000; in Zaire, the threshold collapsed from over $50,000 to a rock bottom $2,000 in 1984; and in Zambia, the government steadily increased the top rate from about 50 percent in the early 1960s to 80 percent.

Kenya, Malawi, and Pakistan enjoyed higher growth than the preceding five nations. Although Kenya sustains a 65 percent top rate, until 1984 the threshold remained well above $20,000, thus exempting all but the upper middle classes. Between 1970 and 1980, Malawi

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enjoyed a relatively low-tax regime by African standards, hovering in the 40 percent range. Malawi's slower progress since 1980 may be attributed partly to its rising top rate and declining threshold, which has now fallen below $10,000. Pakistan illustrates the hazards of failing to adjust thresholds to offset inflation and changes in exchange rates. The effective marginal tax rate faced by successful Pakistanis has sharply increased since 1979, as the threshold declined from nearly $40,000 to under $10,000. Finally, Tanzania is a preposterous case, with a top marginal rate of 95 percent coupled with a rapidly shrinking threshold.

The majority of poorly performing developing countries reveals the same pattern of high and often rising tax rates applied to lower and lower thresholds of income. It is no accident that individual income taxes contribute small proportions of revenue in many of these countries. High tax rates have frustrated the efficient use of labor and capital and have discouraged entrepreneurship, thus holding down growth. As Hong Kong's expatriate rulers have always maintained—and as the Indonesians and Indians have recently discovered—low tax rates applied to high thresholds stimulate growth and provide growing revenue.

Appendix: Annual Changes in Top Marginal Tax Rates and Thresholds for Selected LDCs

The graphs that follow display annual changes in top marginal tax rates and thresholds for selected developing countries from the late 1950s through 1985. Solid lines and bold dashes connect annual observations, and dotted lines connect observations where one or more years are missing in between. As the text indicates, the high growth countries are characterized by low top marginal tax rates or high thresholds, while low growth countries suffer both high rates and low thresholds.

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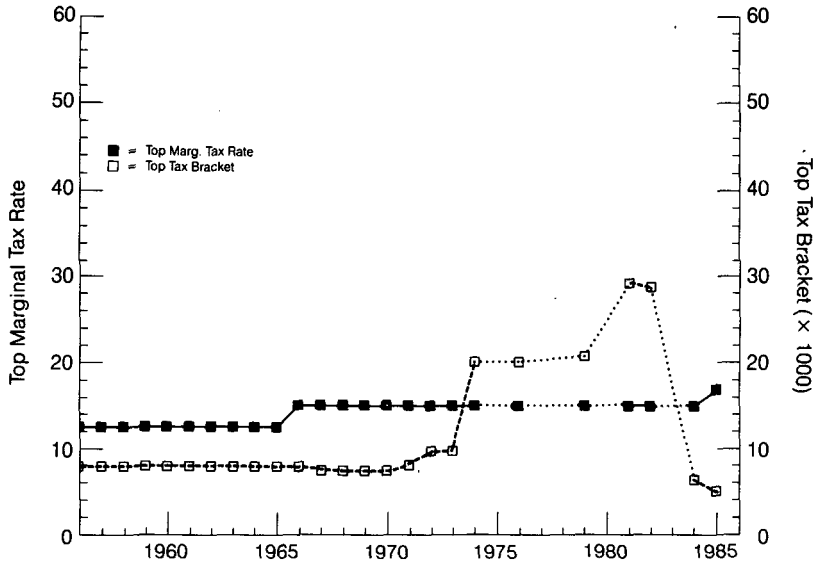
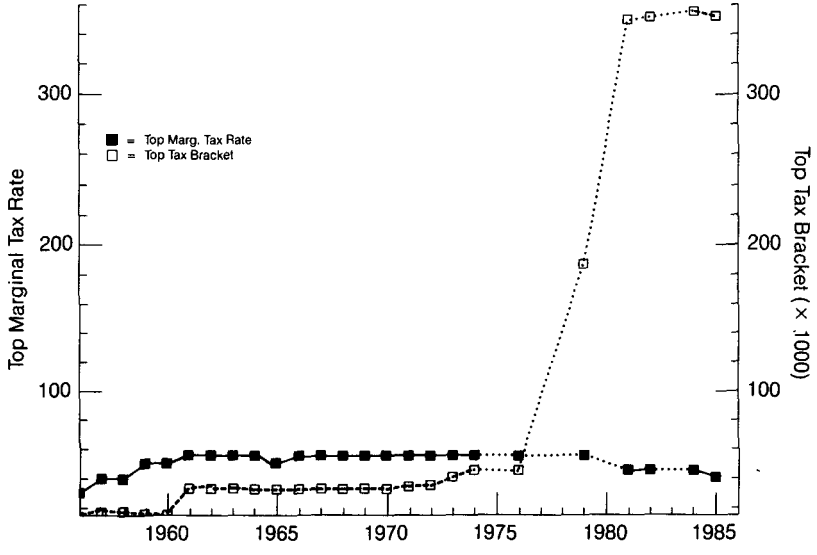
APPENDIX FIGURE 1

INCOME TAX POLICIES: HONG KONG



APPENDIX FIGURE 2

INCOME TAX POLICIES: SINGAPORE



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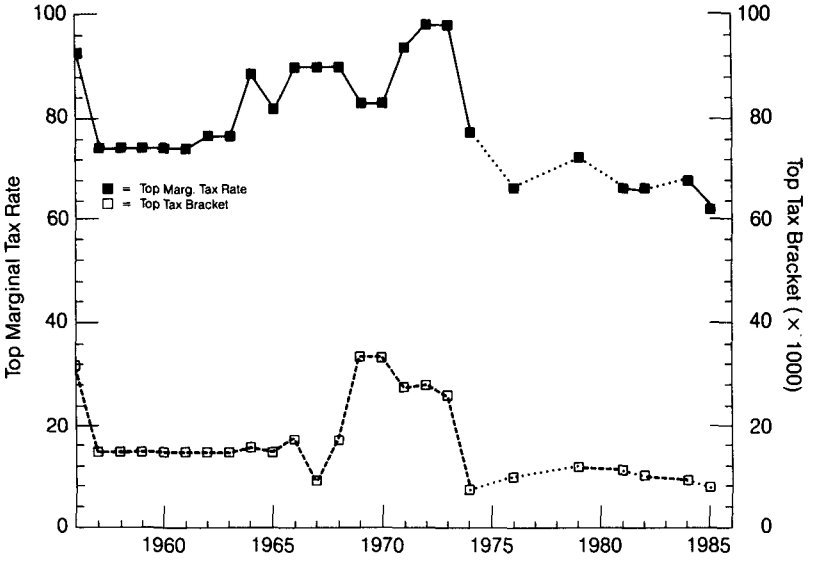
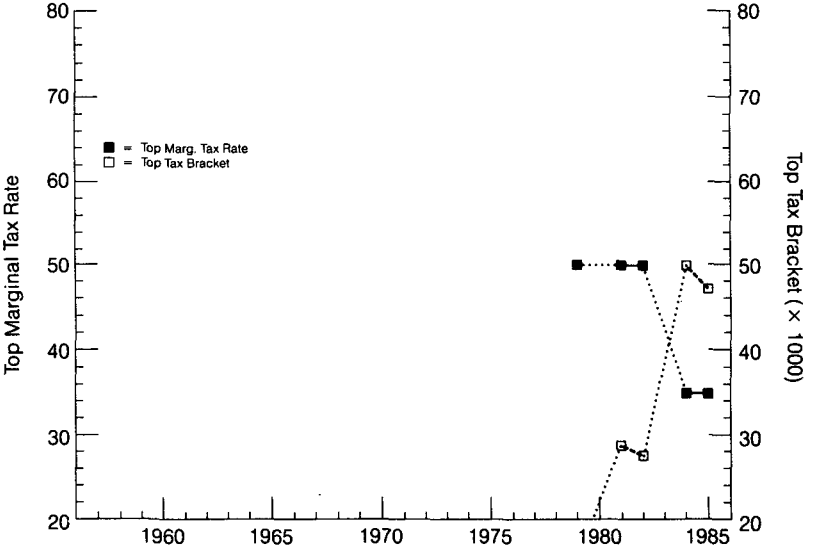
APPENDIX FIGURE 3

INCOME TAX POLICIES: INDIA



APPENDIX FIGURE 4

INCOME TAX POLICIES: INDONESIA



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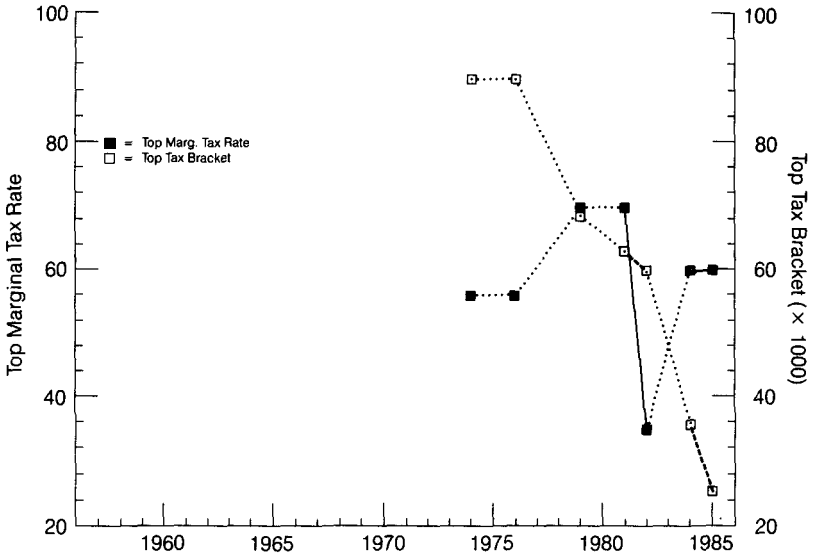
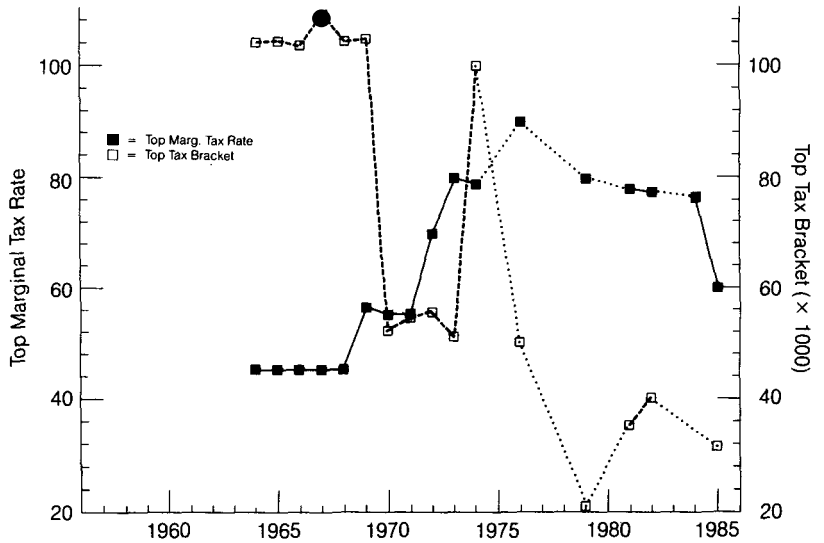
APPENDIX FIGURE 5

INCOME TAX POLICIES: PHILIPPINES



APPENDIX FIGURE 6

INCOME TAX POLICIES: PORTUGAL



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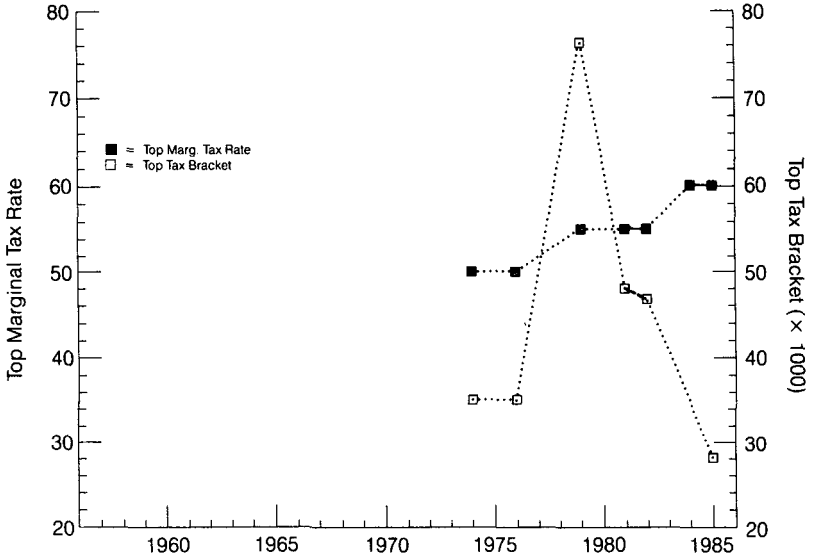
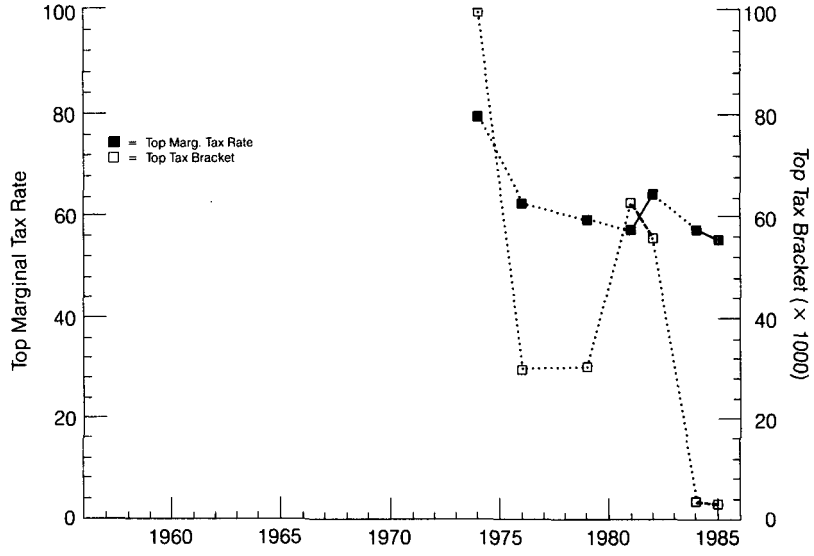
APPENDIX FIGURE 7

INCOME TAX POLICIES: BRAZIL



APPENDIX FIGURE 8

INCOME TAX POLICIES: CHILE



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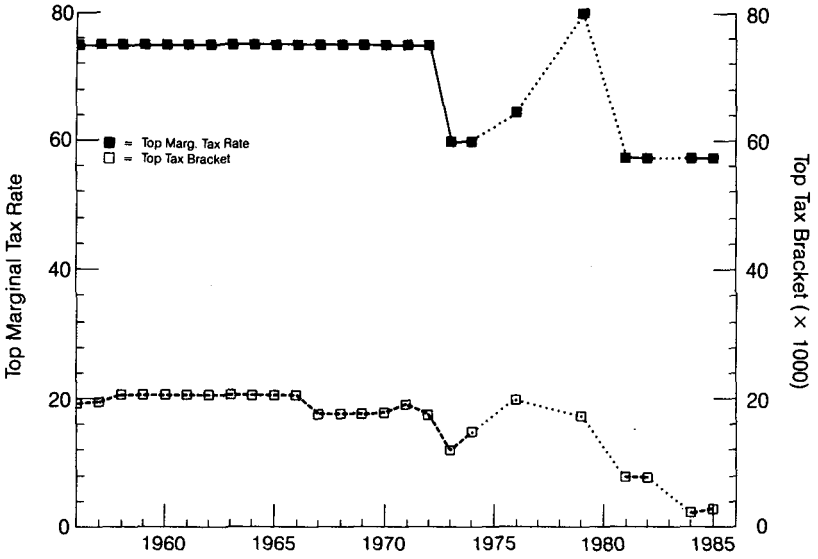
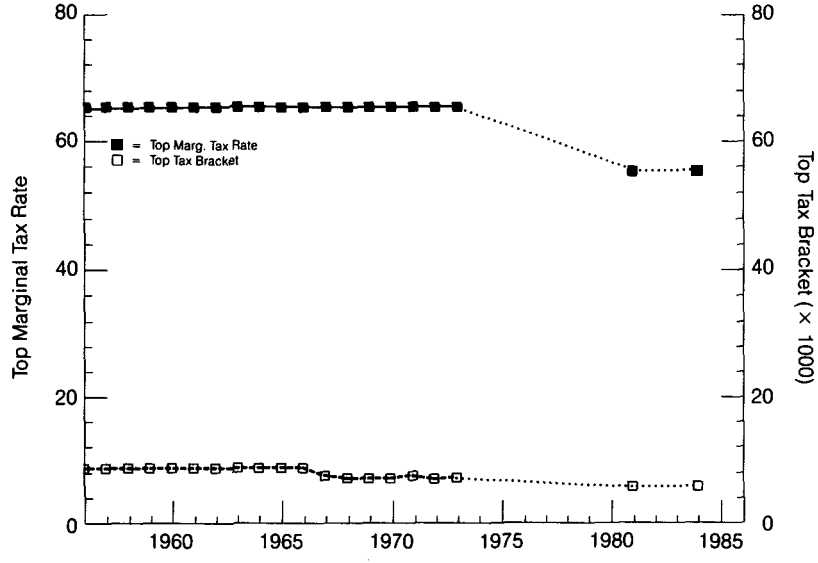
APPENDIX FIGURE 9

INCOME TAX POLICIES: JAMAICA



APPENDIX FIGURE 10

INCOME TAX POLICIES: ST. VINCENT



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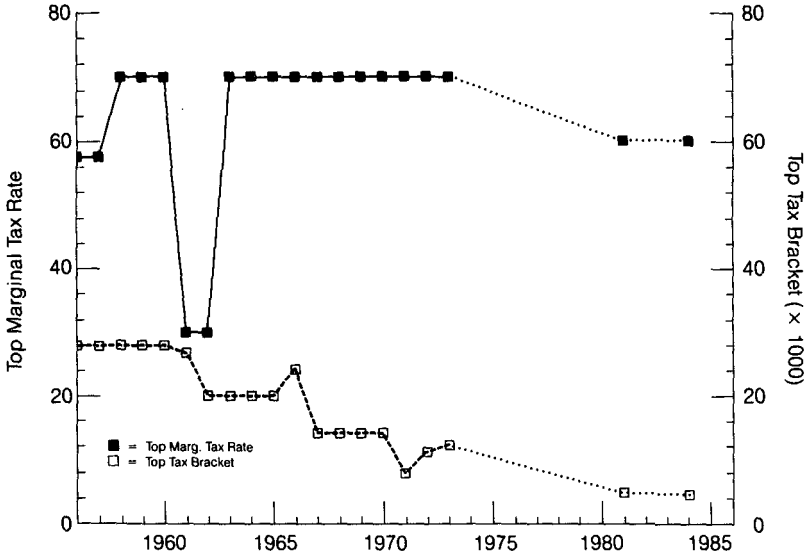
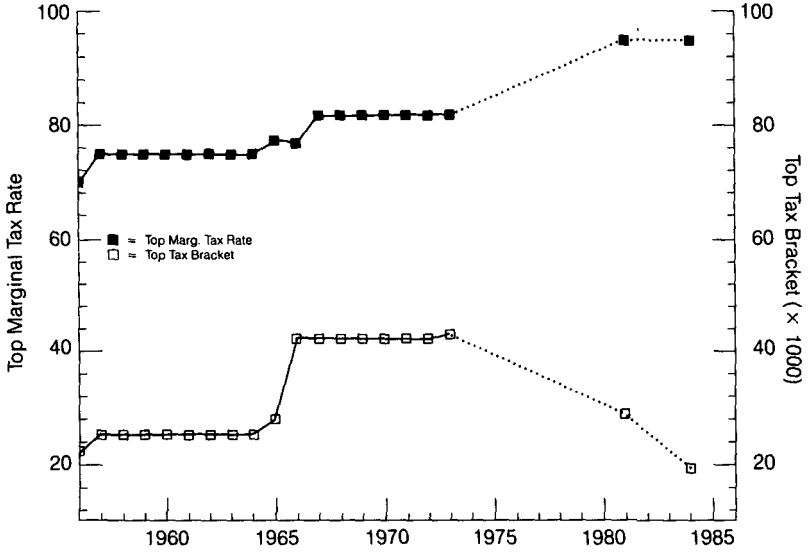
APPENDIX FIGURE 11

INCOME TAX POLICIES: GHANA



APPENDIX FIGURE 12

INCOME TAX POLICIES: TANZANIA



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The Reappraisal of Development Strategies

Keith Marsden

Before commenting on Alvin Rabushka's (1987) stimulating paper, I would like to reminisce briefly about Lord Bauer. Thirty-three years ago I had the good fortune to be supervised for several months by Peter Bauer while I was reading economics at Caius College, Cambridge. Peter was then, and still is, a fellow of Caius. I regret that I did not absorb as much of his wisdom as I should have. Moreover—and probably as a consequence—the quality of my essays did not impress him. But one day my photograph appeared in the *London Times* following the Oxford–Cambridge track meet, which was considered a significant sporting event in England in those days. At the next supervision, he congratulated me and added, somewhat wistfully, "The only time an economist gets his photograph in the *Times* is when he appears in the obituary columns." I am delighted to say this is one of the few prognoses of Peter's that has proved wrong. His stamina, persistence, and integrity in presenting unfashionable ideas have been remarkable. Their fundamental truth has increasingly become recognized in recent years, and he has been deservedly honored with a peerage and even won grudging respect from the most ardent interventionists. We all hope that we will be seeing his photograph, and reading his articles, in the *Times* and elsewhere, for many more years.

Alvin Rabushka's paper makes some important contributions to the reappraisal of development strategies. After burrowing assiduously into not very accessible data, he has come up with convincing evidence that high marginal tax rates create serious disincentives to savings, investment, entrepreneurship, and the application of skills

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The author is Operations Adviser for the Industrial Development and Finance Department of the World Bank. The views expressed in this paper are his own and do not necessarily reflect the official views or policies of the World Bank.

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in countries at widely different stages of development. Their economic performance has been adversely affected as a result. Rabushka has brought out the significance of the income threshold at which top tax rates are applied. He has shown how the combined effects of domestic inflation and exchange rate depreciation have lowered those thresholds, and so influenced the behavior of a large proportion of their populations. He has made very innovative use of data on political freedoms, civil rights, and democratic institutions to question the insidious notion (which many of us have been trying to resist) that the most successful developing countries are those that combine authoritarian political systems with promotion of the private sector and market-oriented economic policies.

Rabushka also has reminded us that, in the field of taxation, as in many other areas of development policy, Peter Bauer's prescience has been striking. As early as 1957, Lord Bauer warned that higher taxation of the monetized sector would retard the spread of an exchange economy and impede long-term growth; that compulsory savings through taxation might not increase total saving; that restricting private saving would dampen the supply of entrepreneurs; and that use of public savings to expand public undertakings would lead to inefficient resource utilization.

Why were Lord Bauer's warnings rejected or ignored for so long? There are many reasons, but I would stress four. First, when many former colonies in Africa, Asia and the Caribbean gained their independence during the 1950s and 1960s, the prevailing political ideologies around the world stressed the role of government in managing the development process. Government was supposed to be benevolent and omniscient, and resources could be allocated more efficiently by central planning than by haphazard market mechanisms, it was believed. Market failures and distortions should be corrected by regulations and administrative controls. The strategic "commanding heights" of the economy must be owned by the state on behalf of the people and not exploited for capitalist greed.

It took several years for these countries to learn from their own experience that those who wield excessive political power over resources often exercise it for narrow self-interest, especially if they are not subjected to the checks and balances of a democratic political system. It also took time for such countries to realize that the information and the know-how available to government officials was generally less precise, and more often than not misused, than the information and know-how possessed by market participants themselves (buyers and sellers). Failures of bureaucratic systems turned out to be more pervasive than market failures. Inefficiency and abuses

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resulting from state monopolies were more pernicious in their effects on peoples' welfare than entrepreneurs striving for profit in a competitive market.

Second, the leaders of many newly independent Third World countries were convinced that genuine political independence required economic independence. They saw that their economies were dominated by foreign companies and ethnic minorities. They had little faith in the entrepreneurial flair or managerial skills of indigenous people engaged in small-scale artisan and trading activities. Small-scale industry was thought to be a relic of the past and a barrier to the adoption of modern technology and economies of scale. So they believed that large-scale public investment had to take the place of foreign private investment as the driving force of self-reliant development. Only recently has the reality of world economic interdependence become evident to the political leadership of these countries: that poor countries can participate in world trade to their advantage and become stronger and more prosperous as a result; that indigenous entrepreneurship is more prevalent than they thought, and only needs a positive, free environment to flourish and time to gain stature and experience; that foreign investors and commercial parters abroad can provide scarce, complementary resources to generate substantial benefits for the national economy, shared by all parties.

Third, development analysts and technocrats must bear part of the blame. Too many were hypnotized by abstract models that reduced the process of development to the interaction of a few key variables, inevitably those that were most easily quantified. Such intangible factors as entrepreneurship, innovation, risk taking, incentives, participation, drive, commitment, opportunities, consumer preferences, freedom to choose, mobility, and liberty were left out of the equations.

Fourth, during the 1970s the debates in international development forums focused on absolute poverty and basic needs. Growth-promoting strategies were said to leave the poor behind. Trickle-down was not enough. Redistribution of assets and incomes became the answer, it was argued. Given the political stance of the main protagonists, evidence of the success of high-growth market economies against such social welfare indicators as nutritional standards, educational levels, life expectancy, and Gini coefficients for income distribution tended to be ignored. Against this background, it is not surprising that fiscal policy was viewed from a narrow, one-sided perspective for many years. Taxes had to be increased in order to raise government revenue. Higher expenditures on government ser-

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vices and public investment were considered indispensable if ambitious social and economic goals were to be achieved.

However, the harsh realities of economic stagnation and decline in Africa, as well as mounting government deficits and public debt in much of Latin America, have begun to raise serious doubts about this strategy in the minds of policymakers and donors of foreign aid. The costs of failed policies are being driven home in the most entrenched political systems. Substantial rethinking of fiscal policy is also going on within the International Monetary Fund, as evidenced by the quotations in Rabushka's paper from Vito Tanzi, director of the fund's fiscal affairs department.

Rabushka's empirical findings, coupled with the cogent analysis of my colleague at the World Bank, Chad Leechor, are contributing significantly to this reappraisal. Reforms of the tax systems are being undertaken in several countries, including Ghana, Zaire, Malaysia, India, and Singapore, to name a few. These reforms are aimed at reducing the disincentive effects of high taxes on private enterprise and personal initiative. They contribute further to the reduction and harmonization of foreign trade taxes, which have been underway for some time in many countries, reflecting a shift from import substitution to outward oriented strategies. These reforms are sometimes accompanied by other measures, such as liberalization of price controls, devaluation of inflated currencies, deregulation of financial markets, and elimination of subsidies to state enterprises. Their aim is to create an environment more conducive to private sector development and open, competitive markets.

There is clearly a long way to go in many countries. But if the initial momentum is maintained, Peter Bauer may need to find other conventional wisdoms to challenge if he is to keep his reputation as the *enfant terrible* of development economics.

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Economic Inequality and the Quest for Social Justice

Karl Brunner

The problem of economic inequality has attracted much attention in recent years. International income differentials were the central concern of the Brandt Report on the so-called North-South Dialogue. The report conveyed a conviction that such differentials are unacceptable and immoral. Responsibility for this condition, moreover, is assigned to wealthy nations. One of Washington's major intellectuals, Sam Donaldson of ABC, also said on David Brinkley's show that the existing income distribution in the United States "is obscene."

Donaldson's attitude and the Brandt Report's evaluation dominate the intelligentsia and the views found in the public arena. We should not, however, be swayed too quickly by such social consensus. We need to ponder the underlying reasons, the problems associated with institutional efforts to establish a more egalitarian society and the consequences of such arrangements. We also may usefully consider whether an egalitarian view of social justice offers the only feasible intellectual position.

Two Views of Justice

Two alternative notions of justice need to be considered: the "end-state," or outcome pattern, concept of justice and its alternative, the "process" concept of justice. We should not draw too firm a line between the two. Some overlapping is possible, which can be elaborated and justified to some extent. Nevertheless, the distinction between them is broad enough to be relevant here. The end-state

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concept basically characterizes social justice in terms of the outcome of the social process. John Rawls's theory of justice belongs to this category and so too does the widely held egalitarian position. Rawls (1971) defines justice as fairness in terms of an admissible class of income distributions. The comparative fate of the lowest income group forms the criterion of admissibility. However, Rawls's discussion seems much too subtle and sophisticated for the public arena. One would look in vain for any discussion of these issues in the pastoral letter of the U.S. Catholic Bishops or in pronouncements offered by other groups on the issue. The basic idea continuously conveyed deplores income inequality. It is evil per se and every decline of inequality moves us closer to social justice.

It is very unclear, however, whether ultimately one really wants to achieve an egalitarian position. The rhetoric seems to be somehow geared to measure the prevailing degree of injustice against this egalitarian scale. Arthur Okun was quite explicit on this point in some of his work, presenting an egalitarian position as the only rational and adequate view of the requirements for justice (see especially Okun 1975). However, he says some tradeoffs in favor of efficiency are unavoidable.

We should also note the views offered by some theologians. Their arguments, however, are generally quite thin and remarkably irrelevant, showing little perception of the relevant issues (see Brunner, et al. 1986). One reads, for example, that justice, as a matter of linguistic logic, can only mean an egalitarian state of income distribution. This rhetoric merely covers theology's inability to cope seriously with the problem of justice. So, we also read that as we all participate equally in Jesus' love, therefore there should be an equal distribution of income. Such assertions remind me of the medieval philosopher who argued that there are seven planets, not eight, not six, not nine, and not five, because there are seven openings in the human head. These arguments share the same level of irrelevance. They contribute nothing to a useful examination of a serious intellectual and social problem of our time.

The "process" concept offers an alternative approach to the problem of justice. Justice is defined not in terms of a specific outcome pattern but as general characteristics of a social process. Outcomes are just to the extent they result from a process that satisfies these broad characteristics representing justice. The process view may be somewhat modified with some redistributive constraints. Such constraints would be designed to protect the lowest income groups in society and "buy" their participation in a social and political consensus.

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The Manna Syndrome

Advocates of an outcome pattern view of justice, typically presenting an egalitarian position, regularly suffer from a peculiar "manna syndrome." We encounter this syndrome in the pastoral letter published by the U.S. Catholic Bishops, and in statements made by the World Council of Churches. The syndrome has also surfaced in the United Nation's advocacy of an international agency to control exploitation of minerals at the bottom of the seas. The manna syndrome is expressed by the view that wealth appears as manna, a gift from God. It follows therefore that all the Earth's resources, as gifts of God, belong to mankind. They must therefore be fairly distributed among all men and women.

The manna syndrome essentially means that its victims deny any feedback from the distribution of wealth to the creation of wealth. The creation of wealth appears thus as an exogenous process showering wealth on society, irrespective of institutional conditions and the resulting behavior of men. It follows naturally that wealth seems arbitrarily redistributable without ill effects on the welfare of society. Once one denies any feedback connection from distribution to creation, any pattern of redistribution may be safely proposed. The wealth creation process, however, depends crucially on the fact that agents can reasonably expect to capture the fruits of their endeavors. Once this connection is broken, the wealth creation process will be seriously impaired.

The Sociological Model of Man

Failure to recognize this problem is closely associated with the prevalent perception of man represented by the sociological model. Arthur Okun's book *Equality and Efficiency* (1975) relies to a large extent on this perception. Man reflects commercial values when operating in the context of private property and market transactions. In the context of nonmarket institutions, man will be guided by higher values that go beyond the dollar and other mean things pursued in commercial transactions. Self-interested behavior can ultimately be overcome by suitable social engineering and by placing man within a proper institutional context. The sociological model thus offers a useful rationale and intellectual support for the end-state vision of justice.

Unfortunately, much confusion about the concept of self-interest prevails in the debate over justice. Such behavior is expressed by the fact that people generally prefer to make their own decisions concerning their affairs. This behavior is quite consistent with altru-

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ism. But concern for other people reflects the assessment and evaluation of the concerned. Even concern for the public's welfare is filtered by the underlying biologically conditioned self-interest. I elaborated this difference in the perception of man a decade ago in an article tracing its consequences for the conception of political institutions (Brunner and Meckling 1977). It also plays a subtle and pervasive role in the assessment of the issues considered here. The sociological model emphasizes the cultural relativity of self-interested behavior and denies a persistent biological component common to all men expressed by general self-interested behavior independent of the institutional context. This context, however, exerts an effect on the specific details or forms in which it will be expressed. Self-interested behavior prevails under market-oriented institutions in some form, and also under nonmarket institutions, but with very different forms of expressions. It will be particularly expressed by competition for power and the manipulation of power mechanisms that operate under nonmarket institutions.

Implications of the Egalitarian Vision

We recognize, therefore, that behind the prevalent view of justice defined in terms of a specific outcome pattern and, in particular, represented by an egalitarian position, lurk two fundamental empirical hypotheses about man and social processes. Wealth is created exogenously, independently of human intentions and volitions guided by institutional incentives. Moreover, the sociological model of man supports and justifies this view. Both positions seem difficult to reconcile with the historical experiences of thousands of years. What now are some of the major implications that follow from all this?

Creation of an Institutional Vacuum

One implication, which I have observed time and again in discussions of social justice, particularly with philosphers, is the presence of a peculiar institutional vacuum. This neglect of any institutional context follows from the two points stated above. If wealth is exogenous and a sociological model of man is used, then the specific implementation of redistributional *activities* really does not matter very much. It has simply no feedback and therefore is not worth discussing.

Rawls's book on justice, *A Theory of Justice* (1971), excellent and interesting as it is in many ways, reflects the institutional vacuum so prevalent in many discussions of our subject. We rarely encounter any attempt to examine the detailed nature of the institutional imple-

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mentation of any particular end-state criterion. Neither do we find a searching examination of the consequences to be expected from such implementation. Economic analysis tells us that we should expect serious consequences. Every institutional arrangement influences the opportunity set confronting individuals, and therefore affects the behavior of those individuals. Any *change* in institutional arrangements also changes opportunity sets and modifies individual behavior. The implementation of any particular criterion of outcome pattern would really amount to a sequence of continuous reimplementations with new institutional efforts directed to force society into the procrustean bed so ardently advocated. The dream of an egalitarian society will never be realized, and attempts to impose it produce only poverty, stagnation, and oppression.

Disregard of the Production–Distribution Nexus

The egalitarian view is occasionally justified with the observation that there exists no systematic connection between economic growth and income inequality. This observation seems to suggest to some that there is no feedback from distribution to productive efforts and ingenuity. However, economic inequality is not a sufficient condition of economic growth. Economic inequality and stagnation or poverty are frequently the joint result of policies that obstruct economic development. The policies of many Third World countries foster stagnation and, simultaneously, a redistribution of wealth to the ruling oligarchy and its clientele. Economic inequality will often result from institutional arrangements that obstruct economic growth. The observation that economic growth and income inequality are uncorrelated thus offers no support for the thesis asserting the possibility of an egalitarian society without any effect on general welfare.

The Loss of an Open Society

A society guided by an egalitarian vision is committed to choose institutions that establish pervasive instruments of political repression together with conditions of poverty and stagnation. Our search for justice needs certainly to look elsewhere for humane solutions. The process concept of justice deserves substantially more serious attention than it has been granted in the public arena. This conception of justice addresses a fundamental question bearing on the nature of social and political institutions that offer members of society the best opportunity to shape their lives and improve their lot. Such arrangements unavoidably allow a persistent inequality in the distribution of income. This does not mean, however, that specific social groups are permanently locked into particular positions of the income

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distribution. An open society produces substantial social circulation within the income distribution pattern over successive generations. We need also to emphasize once more that a society guided by the egalitarian principle will necessarily develop institutions of control and management that ultimately maintain substantial inequality of economic status and political power.

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Population Growth, Economic Growth, and Foreign Aid

Julian L. Simon

Introduction

It is a great honor, as well as a great pleasure, for me to contribute to this Festschrift honoring Peter Bauer and his pathbreaking work on economic development. My acquaintance with Bauer's point of view goes back to about 1970 when I first taught a graduate course in development economics. At that time I fortunately discovered *The Economics of Underdeveloped Countries*, coauthored by Bauer and Basil Yamey (1957). Its analyses and case studies gave me confidence in saying to the class what my survey of the literature had already suggested, namely, that development economics is no different than any other economics. Still, my appreciation of Bauer's point of view has taken years to deepen and ripen, in conjunction with my reading of F. A. Hayek on related topics. Only in the past few years have I absorbed it enough to give it nearly proper place in my own work. It is therefore gratifying to see Bauer's work gaining increasing recognition in the field of development economics.

I am also grateful that, just as I have learned so much from Peter Bauer, he has been kind enough to say that he has learned something from my work—that population growth is not inimical to economic development, as early on he had written it is. Indeed, this idea fits perfectly with the rest of his thinking. So this Festschrift is an unusual opportunity for me, because it is the perfect occasion to discuss the juxtaposition of Bauer's central idea about the importance of markets and liberty in economic development and the place of population

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The author is Professor of Business Administration at the University of Maryland. The paper draws on a variety of the author's other writings on the subjects at hand, especially Simon (1985a, 1985b). The author wishes to thank David Boaz and Theodore W. Schultz for their helpful comments on an earlier version of the paper. Stephen Moore helped prepare Tables 1–5, and Mike Waters helped prepare Table 6.

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growth in that process. This juxtaposition is especially appropriate because population growth has been the topic on which development "planners" have focused the world's attention to the neglect of, and perhaps as a device for being able to avoid attending to, the key role of economic freedom and market processes. This Festschrift is also an excellent opportunity to use as a backdrop and as a foil the recent report of the National Academy of Sciences, *Population Growth and Economic Development* (1986).

The main points of my paper are the following: First, it is the processes that Bauer emphasizes that account for the speed of a country's economic development. I will adduce some data on three pairs of countries that I think are strong added evidence for that view: North and South Korea, East and West Germany, and China and Taiwan. Second, the rate of population growth does *not* determine the rate of economic development; the same data set supports this point. A corollary is that a more dense population does not hamper population growth; this is attested to by the same data as well as by other data that I will mention. Third, though intentions may be benign (though they certainly are not always so), some aspects of U.S. foreign aid programs for "family planning" are not just wasteful, not just fraudulent, not even just politically dangerous for the United States; but they may well be extremely damaging on net balance by offering a palliative that distracts from the all-important issue of the economic system of the country receiving the aid.

All three points can be subsumed under the single lesson that Henry Hazlitt (1962, p. 17) tried to teach in *Economics in One Lesson:* "The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups."

The Role of Population Size, Growth, and Density in Economic Progress

Tables 1–5 compare pairs of countries that have the same culture and history, and had much the same standard of living when they split apart after World War II: North and South Korea, East and West Germany, China and Taiwan. The tables make it abundantly clear, despite the frequent absence of data for the centrally planned countries, that the market-directed economies have performed much better economically, no matter how economic progress is measured. Income per person is higher. Wages have grown faster. Key indicators of infra-structure, such as telephones per person, show a much higher

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TABLE 1

POPULATION DENSITY AND GROWTH, SELECTED COUNTRIES, 1950–83

	East Germany	West Germany	North Korea	South Korea	China	Taiwan	Hong Kong	Singapore	USSR	USA	India	Japan
Population per Sq. Km., 1950	171	201	76	212	57	212	2236	1759	8	16	110	224
% Change in Pop., 1950	1.2	1.1	−7.8	0.1	1.9	3.3	−10.4	4.4	1.7	1.7	1.7	1.6
% Change in Pop., 1955	−1.3	1.2	3.5	2.2	2.4	3.5	4.9	4.9	1.8	1.8	1.9	1.0
% Change in Pop., 1960	−0.7	1.3	3.0	3.3	1.8	3.1	3.0	3.3	1.8	1.7	2.0	0.9
% Change in Pop., 1970	−0.1	1.0	3.0	2.4	2.4	2.2	2.2	1.7	1.0	1.1	2.2	1.3
% Change in Pop., 1983	−0.3	−0.2	2.1–2.6	1.4–1.6	1.3–1.6	1.8	1.5	1.2	0.7–0.9	0.9	2.1–2.2	0.6

SOURCES: Population per square km.: United Nations Educational, Scientific, and Cultural Organization, *UNESCO Yearbook* (1963, pp. 12–21). Percentage change in population: U.S. Department of Commerce, *World Population* (1978); United Nations, Report on *World Population* (1984).

TABLE 2

REAL INCOME PER CAPITA, SELECTED COUNTRIES, 1950–82

	East Germany	West Germany	North Korea	South Korea	China	Taiwan	Hong Kong	Singapore	USSR	USA	India	Japan
Real GDP per capita, 1950[a]	1480	1888	n.a.	n.a.	300	508	n.a.	n.a.	1373	4550	333	810
Real GDP per capita, 1960	3006	3711	n.a.	631	505	733	919	1054	2084	5195	428	1674
Real GDP per capita, 1970	4100	5356	n.a.	1112	711	1298	2005	2012	3142	6629	450	4215
Real GDP per capita, 1980	5532	6967	n.a.	2007	1135	2522	3973	3948	3943	8089	498	5996
Real GNP per capita, 1950[b]	Same as W. Germ.	2943	Same as S. Korea	193	n.a.	417	1053	n.a.	n.a.	7447	217	649
Real GNP per capita, 1960	n.a.	3959	n.a.	473	n.a.	429	979	1330	n.a.	8573	220	1403
Real GNP per capita, 1970	6584	6839	556	615	556	868	1807	2065	4670	10769	219	4380
Real GNP per capita, 1982	9914	11032	817	1611	630	2579	5064	5600	5991	12482	235	9774

[a]Figures for real gross domestic product (GDP) per capita are based on 1975 international prices.
[b]Figures for real gross national product (GNP) per capita are based on 1981 constant U.S. dollars.
SOURCES: Real GDP per capita: Summers and Heston (1984). Real GNP per capita: International Bank for Reconstruction and Development (IBRD), *World Tables* (1980). GNP deflator: Council of Economic Advisers (1986, Table B–3).

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TABLE 3

LIFE EXPECTANCY AND INFANT MORTALITY, SELECTED COUNTRIES, 1960–82

	East Germany	West Germany	North Korea	South Korea	China	Taiwan	Hong Kong	Singapore	USSR	USA	India	Japan
Life Expectancy at Birth, 1960	68	69	54	54	53	65	65	64	68	70	43	68
Life Expectancy at Birth, 1982	73	74	65	68	67	73	76	73	69	75	55	77
Infant Mortality, 1960	39	34	78	78	165	32	37	35	33	26	165	30
Infant Mortality, 1982	12	12	32	32	67	18	10	11	28	11	94	7

SOURCE: IBRD, *World Development Report* (1985, pp. 260–61).

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TABLE 4

INDUSTRIALIZATION AND URBANIZATION, SELECTED COUNTRIES, 1960–82

	East Germany	West Germany	North Korea	South Korea	China	Taiwan	Hong Kong	Singapore	USSR	USA	India	Japan
% Labor Force in Agric., 1960	18	14	62	66	n.a.	n.a.	8	8	42	7	74	33
% Labor Force in Agric., 1980	10	4	49	34	69	37 (1978)	3	2	14	2	71	12
% Urbanized, 1960	72	77	40	28	18	58	89	100	49	70	18	63
% Urbanized, 1982	77	85	63	61	21	70 (1980)	91	100	63	78	24	78

SOURCES: Labor force in agriculture: IBRD, *World Development Report* (1985, pp. 258–59). Urban population: IBRD, *World Development Report* (1985, pp. 260–61).

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TABLE 5

EDUCATION AND CONSUMPTION, SELECTED COUNTRIES, VARIOUS YEARS

	East Germany	West Germany	North Korea	South Korea	China	Taiwan	Hong Kong	Singapore	USSR	USA	India	Japan
Higher Education Enrollment, 1960	16	6	n.a.	5	n.a.	n.a.	4	6	11	32	3	10
Higher Education Enrollment, 1982	30	30	n.a.	22	1	n.a.	12	10	21	56	9	31
Newsprint per Person, 1950–54	3.5	5.1	n.a.	0.6	n.a.	0.9	4.3	n.a.	1.2	35.0	0.2	3.3
Newsprint per Person, 1982	9.6	21.5	0.1	5.8	1.2	n.a.	16.4	32.1	4.5	44.1	0.4	24.0
Telephones per 100 Pop., 1983	20.6	57.1	n.a.	14.9	0.5	25.8	38.2	36.7	9.8	76.0	0.5	52.0
Autos per 100 Pop., 1960	0.9	8.2	n.a.	0.1	0.005	0.1	1.0	4.2	0.3	34.4	0.1	0.5
Autos per 100 Pop., 1970	6.7	24.1	n.a.	0.2	0.018	n.a.	2.8	7.2	0.7	43.9	0.1	8.5
Autos per 100 Pop., 1984	18.9	41.3	n.a.	1.1	0.010	3.1	4.6	9.3	3.9	55.5	0.2	22.8

SOURCES: Higher education: IBRD, *World Development Report* (1985, pp. 266–67). Newsprint: *UNESCO Yearbook* (1963, pp. 400–409). Telephones: U.S. Department of Commerce, *Statistical Abstract* (1986, p. 845). Automobiles: Motor Vehicle Manufacturers Association of the U.S. Inc., *World Motor Vehicle Data* (various years).

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level of development. And indicators of individual wealth and personal consumption, such as automobiles and newsprint, show enormous advantages for the market-directed enterprise economies compared to the centrally planned, centrally controlled economies. Furthermore, birth rates fell at least as early and as fast in the market-directed countries as in the centrally planned countries.

The first line in Table 1 shows that in each case the centrally planned communist country began with less population "pressure," as measured by density per square kilometer, compared to the paired market-directed noncommunist country. And the communist and noncommunist countries in each pair also started with much the same birth rates and population growth rates. There is certainly no evidence here which suggests that population growth or density influences the rate of economic development.

The most important evidence on the relationship between the rate of population growth and the rate of economic growth is the global correlations, the data that first shook my conventional belief that population growth was the twin of war as the world's great evils. There now exist perhaps a score of competent statistical studies, beginning in 1967 with an analysis by Simon Kuznets covering the few countries for which data are available over the past century, and also analyses by Kuznets and Richard Easterlin of the data covering many countries since World War II. The basic method is to gather data on each country's rate of population growth and its rate of economic growth, and then to examine whether—looking at all the data in the sample together—the countries with high population growth rates have economic growth rates lower than average, and countries with low population growth rates have economic growth rates higher than average. Various writers have used a variety of samples of countries, and have employed an impressive battery of ingenious statistical techniques to allow for other factors that might also be affecting the outcome.

The clear-cut consensus of this body of research is that faster population growth is *not* associated with slower economic growth. Of course one can adduce cases of countries that seemingly are exceptions to the pattern. It is the genius of statistical inference, however, to enable us to draw valid generalizations from samples that contain wide variations in behavior. The exceptions can be useful in alerting us to possible avenues for further analysis, but as long as they are only exceptions, they do not prove that the generalization is not meaningful or useful.

This body of literature is now almost two decades old, researched by scientists with the best possible credentials (many of whom expected

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to find a negative effect), and published in well-known scientific journals. Yet, not one of these studies is commonly mentioned in the newspaper reports, by the United Nations Fund for Population Activities documents for the 1984 Mexico City Conference or other mainline statements on the subject, nor by the extensive 1984 World Development Report of the World Bank.

The recent National Academy of Sciences (NAS) report on *Population Growth and Economic Development* (1986, p. 7) at least took notice of this body of literature, but dismissed it as follows:

> [S]imple correlations between population growth and per capita income, although intriguing, ultimately provide little insight into the causal impact of a policy-driven decline in fertility. A scientific assessment of the impact requires that one identify the major mechanisms by which population growth is hypothesized to affect economic development; assess the evidence for each hypothesis; and, finally, synthesize the net effect of the simultaneous operation of these mechanisms.

An examination is badly needed of the reliability of those studies and the validity of their conclusions in light of the best statistical-econometric thinking, because on the rare occasion when these studies are mentioned, they are dismissed as either unpersuasive (as in the NAS report) or as completely without scientific value. For example, Robert Repetto (1985) called all of these studies "meaningless," saying: "Everyone knows that statistical correlations between two variables don't tell which is influencing the other, or whether a third variable is influencing both." A full-scale assessment needs badly to be done, but I cannot undertake it here. Nevertheless, four points seem to be in order.

First, it is true that two-variable correlation studies do not indicate the forces that *do* causally influence economic development. But a two-variable zero correlation can be very strong evidence—especially when buttressed with multivariate studies with a variety of specifications—that one variable (population growth) does *not* cause the other (economic development).

Second, many of the studies of population and economic development have gone far beyond the simple two-variable correlations.

Third, not only does a correlation not "prove" causation, as the popular saw has it, but no other scientific procedure—not even a lengthy series of experiments—can "prove" causation, either (see Simon 1970).

Fourth, simple correlations of the rate of economic growth and the rate of population growth are biased toward a more negative (less positive) correlation, because the appropriate measure of economic

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development is the rate of change of output *per worker* while the usual variable is *per person*. Substituting the former for the latter pushes the correlation coefficient in a positive direction.

It has been suggested (for example, Conner 1984) that the studies showing the absence of a relationship between the population rate and the economic growth rate also demonstrate that additional people do *not* imply a *higher* standard of living in the long run. That is, because these studies do not show a *positive* correlation, one is said to make claims beyond the evidence if one says that over the very long sweep of human history a larger population in the world (or, perhaps, in what is the developed part of the world at any moment) has meant faster rates of increase in technology and the standard of living.

It is indeed the case that existing empirical studies do not prove that rapid population growth in the more developed world as a whole *increases* income per person. But this is not inconsistent with the proposition that more people raise the standard of living in the long run. Recall that the studies mentioned above do not refer to the *very* long run, but rather usually cover only a quarter of a century, or a century at most. The main *negative* effects of population growth occur during perhaps the first quarter or half of a century, so that if these effects *are* important the empirical studies referred to should reveal them. These shorter-run effects on the standard of living include the public costs of raising children—schooling and health are the main examples—and the costs of providing additional production capital for the additional persons in the work force. The absence of an observed negative effect on economic growth in the statistical measures, therefore, is enough to imply that in the very long run more people have a *positive* net effect. This is because the most important positive effects of additional people—improvement of productivity through both the contribution of new ideas and also the learning-by-doing consequent on increased production volume—happen in the long run and are cumulative. To put it differently, the statistical measurements of the relationship of population growth to economic growth are biased in favor of showing the shorter-run effects, which tend to be negative, and not showing the longer-run effects, which tend to be positive. If such negative effects do not appear, one may assume that an unbiased measure of the total effect would reveal a positive effect of population growth on economic growth.

There is still another reason why the studies mentioned above do not imply an absence of positive effect in the long run: they focus on the *process* of population *growth*. If we look instead at the *attained level* of population—that is, the population density as measured by

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the number of persons per square mile—we see a somewhat different result. Studies of more developed countries (MDCs) are lacking. But Everett Hagen (1975) and Charles Kindleberger (1965) show visually, and Simon and Gobin (1979) show in multivariate regressions, that higher population density in less developed countries (LDCs) is associated with *higher* rates of economic growth. This effect may be strongest at low densities, but there is no evidence that the effect reverses at high densities. Again, the statistical evidence directly contradicts the common-sense conventional wisdom. That is, if you make a chart with population density on the horizontal axis and either the income level or the rate of change of income on the vertical axis, you will see that higher density is associated with better rather than poorer economic results.

Check for yourself. Fly over Hong Kong—just a few decades ago a place seemingly without prospects because of insoluble resource problems—and you will marvel at the astounding collection of modern high-rise apartments and office buildings. Take a ride on its excellent smooth-flowing highways for an hour or two, and you will realize that a very dense concentration of human beings does not prevent comfortable existence and exciting economic expansion, as long as the economic system gives individuals the freedom to exercise their talents and to take advantage of opportunities. And the experience of Singapore demonstrates that Hong Kong is not unique. Two such examples do not prove the case, of course. But these dramatic illustrations are backed by the evidence from the aggregate sample of countries, and hence do not mislead us.[1]

The data showing a positive effect of density on economic growth constitute indirect proof of a positive long-run effect of population *growth* on economic growth, because density changes occur very slowly, and therefore the data pick up the very long-run effects as well as the short-run effects.[2]

[1]Hong Kong is a special thrill for me because I first saw it in 1955 when I went ashore from a U.S. Navy destroyer. At that time I felt great pity for the thousands of people who slept every night on the sidewalks or on small boats. It then seemed clear to me, as it must have to every observer, that it would be impossible for Hong Kong to surmount its problems—huge masses of impoverished people without jobs, total lack of exploitable natural resources, more refugees pouring across the border each day. And it is this sort of picture that has convinced many persons that a place is "overpopulated" and should cut its birth rate (for example, Paul Ehrlich at the beginning of *The Population Bomb*). But upon returning in 1983, I saw bustling crowds of healthy, vital people full of hope and energy. No cause for pity now.

[2]It may at first seem preposterous that greater population density might lead to better economic results. This is the equivalent of saying that if all Americans moved east of the Mississippi, we might not be the poorer for it. Upon reflection, this proposition is

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In the very short run, additional people are an added burden. But under conditions of freedom, population growth poses less of a problem in the short run, and brings many more benefits in the long run, than under conditions of government control. To illustrate, compare China with Singapore.

China's coercive population policy, including forced abortions, is often called "pragmatic" because its economic development supposedly requires population control. For example, typically in a recent *Washington Post* supplement (in the context of an article on an eight-year-old Chinese dancer; every writer an expert on population!) the author tells us that "China strictly enforces a policy of one child per family [which] seems unnecessarily harsh and dispiriting. . . . [But] then one encounters the reality. . . . What does one do in a country that has 1.3 billion people, 27 percent of the world's population, to be fed from only 7 percent of the world's arable land?"

Contrast Singapore. Despite its very high population density, Singapore suffers from what it considers a labor shortage and imports workers. The country is even considering incentives for middle-class families to have more children, in contrast to its previous across-the-board anti-natality policy. This raises the question whether there are economic grounds for China to even *ask* people to have only one child.

Tables 1–5 include data on Hong Kong and Singapore for additional comparisons with China. The experience of these countries, whose people largely share with China their language, history, and culture, give additional proof that China's problem is not too many children but rather a defective political-economic system. With free markets China might soon experience the same sort of labor shortage as found in Singapore, which is vastly more densely settled and has

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not as unlikely as it sounds. The main loss involved in such a move would be huge amounts of farmland, and though the United States is a massive producer and exporter of farm goods, agriculture is not crucial to the economy. Less than 3 percent of U.S. income comes from agriculture, and less than 3 percent of the U.S. working population is engaged in that industry. The capitalized value of all U.S. farmland is a little more than a tenth of one year's national income, so even if the United States were to lose all of it, the loss would equal only about one year's expenditures upon liquor, cigarettes, and the like. On the other hand, such a change would bring about major benefits in shortening transportation and communication distances, a factor that has been important in Japan's ability to closely coordinate its industrial operations in such a fashion as to reduce costs of inventory and transportation. Additionally, greater population concentration forces social changes in the direction of a greater degree of organization, changes that may be costly in the short run but in the long run increase a society's ability to reach its economic and social objectives. If we were still living at the population density of, say, 10 thousand years ago, we would have none of the vital complex social and economic apparatuses that are the backbone of our society today.

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no natural resources. (This does not mean a "free" system such as China is talking about now; it is quite unlikely that a truly free market can coexist with a totalitarian political system, because a free economy is too great a political threat.)

It is said, however: Hong Kong and Singapore are different because they are city-states. But what does that mean—that if large hinterlands were attached to those "city-states" they would then be poorer, as China is?

At this point the question frequently arises: If more people cause there to be more ideas and knowledge, and hence higher productivity and income, why are not India and China the richest nations in the world? Let us put aside the matter that size in terms of population within national boundaries was not very meaningful in earlier centuries when national integration was much looser than it is now. But there remains the question of why so many human beings in those countries have produced so little change during the last few hundred years. In earlier writing I suggested that low levels of education of most people in China and India prevented them from producing knowledge and change, though noting the very large (in absolute terms) contemporary scientific establishments in those two countries. But though education may account for much of the present situation, it does not account nearly as well for the differences between the West and the East over the five centuries or so up to, say, 1850.

William McNeill (1963), Eric Jones (1981), and others have suggested that over several centuries the relative instability of social and economic life in Europe, compared to China and India, helps account for the emergence of modern growth in the West rather than in the East. Instability implies economic disequilibria, which, as Theodore Schultz (1975) reminds us, imply exploitable opportunities that then lead to augmented effort. (Such disequilibria also cause the production of new knowledge, it would seem.)

The hypothesis that the combination of a person's wealth and opportunities affect the person's exertion of effort may go far in explaining the phenomenon at hand. Ceteris paribus, the less wealth a person has, the greater the person's drive to take advantage of economic opportunities. The village millions in India and China certainly have had plenty of poverty to stimulate them. But they have lacked opportunities because of the static and immobile nature of their village life. In contrast, villagers in Western Europe apparently had more mobility, less stability, and more exposure to cross-currents of all kinds.

Just why Europe should have been so much more open than India and China is a question that historians answer with conjectures about

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religion, smallness of countries with consequent competition and instability, and a variety of other special conditions. This matter need not be pursued here. But I should at least mention Deepak Lal's forthcoming book on India's economic development over thousands of years, which suggests that it was only the rapid population growth starting around 1921 that cracked the "cake of custom" and the Hindu caste system, and caused the mobility that allowed India to begin modern development.

Most, if not all, historians of the period (for example, Nef 1958; Gimpel 1976) agree that the period of rapid population growth from before AD 1000 to the beginning of the mid-1300s was a period of extraordinary intellectual fecundity. It was also a period of great dynamism generally, as seen in the extraordinary cathedral building boom. But during the period of depopulation due to the plague (starting with the Black Death cataclysm) and perhaps to climatic changes from the mid-1300s (though the change apparently began earlier at the time of major famines around 1315–17, and perhaps even earlier, when there also was a slowing or cessation of population growth due to other factors) until perhaps the 1500s, historians agree that intellectual and social vitality waned.

Henri Pirenne's magisterial analysis ([1925] 1969) of this period depends heavily on population growth and size. Larger absolute numbers were the basis for increased trade and consequent growth in cities, which in turn strongly influenced the creation of a more articulated exchange economy in place of the subsistence economy of the manor. And according to Pirenne, growth in population also loosened the bonds of the serf in the city and thereby contributed to an increase in human liberty (though the causes of the end of serfdom are a subject of much controversy).

A corollary, of course, is that once the people in the East lose the shackles of static village life and get some education, their poverty (absolute and relative) will drive them to an extraordinary explosion of creative effort. The events in Taiwan and Korea in recent decades suggest that this is already beginning to occur.

This explanation would seem more systematic, and more consistent with the large body of economic thought, than are explanations in terms of Confucianism or of particular cultures, just as the Protestant-ethic explanation for the rise of the West (discussion of which goes back at least to Hume) now seems unpersuasive in the face of religious counter-examples (for example, the Catholic Ibo in Nigeria) and shifts in the behavior of Protestant nations.

Contemporary Africa is cited as an example of population growth hampering economic development—for example the quote from the

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NAS report cited earlier, and Lester Brown's recent statement that Africa "is losing the ability to feed itself. . . . Slowing population growth, conserving soils, restoring forests and woodlands, and enhancing subsistence agriculture are sure to be cornerstones of successful efforts to reestablish working economies in Africa" (Brown and Wolf 1985, p. 7). Changing the economic and political system is not mentioned.

We ought to learn from the fact that exactly the same dire assessments were heard in the past, and have proven false. For example, in 1965 Brown applied virtually the same words to Asia: "The less-developed world is losing the capacity to feed itself. . . . Only in Africa . . . has a downward trend been avoided" (as quoted in Tierney 1986, p. 38). Population growth did not prevent Asia and the rest of the less-developed world from "feeding itself" better and better with the passage of years (though self-sufficiency is not a sensible economic goal in a world where trade is possible). Of course, Asia's development might conceivably have been even faster with slower population growth, but no evidence supports such speculation.

The Role of Foreign Aid for "Family Planning"

I wish to say as loudly and clearly as possible: I believe that a couple's ability to have the family size the couple chooses is one of the great goods of human existence. And I am not in principle against a government's giving "family planning" assistance to its own citizens or to citizens of another country if they so desire. I especially cheer efforts to strengthen commercial organizations that provide such assistance through market channels. I emphasize this even though it should not even require saying, because many persons in the population "movement" disingenously and maliciously assert that people who hold such views as expressed here are against "family planning." But it does *not* follow from being in favor of informed, responsible parenthood that the United States should automatically give foreign aid to organizations that request funds in the name of "family planning," on the grounds that *some* good will be done by the funds even if they are largely wasted or used perversely.

If you ask the population "establishment" why we should and do give such "aid," the answer almost invariably is a masterpiece of doubletalk, arguments made out of both sides of the mouth. On the one hand, the United Nations Fund for Population Activities (UNFPA) and such congressional population-control enthusiasts as James Scheuer and Sander Levin say that their aim simply is to supply "family planning" in order to help people achieve the family size

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that they wish. Everyone that I know of—including the Vatican, as I understand it—agrees with the aim that families should have the number of children that they wish and believe they can raise well. If family planning were all there is to the matter, we could all easily agree on a one-page statement of goals and means (putting aside the troublesome but obfuscating issue of abortion), and we would not need multi-million dollar conferences and reams of documents and bushels of expensive research reports and fancy organizational publications financed directly and indirectly by the American taxpayer. We could simply say that as an act of plain helpful generosity, we recommend that governments do what they can to provide contraceptive information and devices through private and public channels, and we will do what we can to help.

The arguments of the population organizations are another matter, however. They wring their hands over population growth rates, economic development, natural resource availability, unemployment, social conflict, and the like. A typical example is from a January 1986 cover letter to the annual report from Bradman Weerakoon, the secretary general of the International Planned Parenthood Federation (IPPF): "IPPF believes that knowledge of family planning is a fundamental human right and that a balance between the population of the world and its natural resources and productivity is a necessary condition of human happiness, prosperity and peace." It is clear, especially in the UNFPA statements, that their aim is not simply to help individuals achieve the family size that the individual couples would otherwise like. Rather, these organizations aim at population growth-rate goals—more specifically, at zero population growth—that the leaders of these organizations have decided are desirable for the world.

Furthermore, even the most "moderate" group, the recent NAS Committee on Population, is prepared to go beyond simple provision of information and devices: "When a couple's childbearing decision imposes external costs on other families—in overexploitation of common resources, congestion of public services, or contribution to a socially undesirable distribution of income—a case may be made for policies that go 'beyond family planning' " (NAS 1986, p. 93). The policies discussed include persuasive campaigns to change family size norms as well as combinations of incentives and taxes related to family size.

Cynical observers have suggested that talk about population growth rates is just eyewash to obtain more support for the laudable goal of effective family planning. There are two things wrong with this argument. First, how do we know that these cynics are not manipu-

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lating the family-planning appeal to obtain the goal of population reduction rather than vice versa? Second, and more important, can false rhetoric be justified if the end is thought to be good? What about the terribly costly ill effects of the false forecasts of resource gloom and doom over the past two decades? For example, our airlines, airplane manufacturers, and automobile industries have lost tens of billions of dollars in design and manufacturing expenses because they relied on—or were forced by government regulation to rely on—forecasts that the price of gasoline would soon be three dollars a gallon. The banks that lent money to oil ventures now find they are eating tens of billions of dollars in bad loans made on the basis of those forecasts of increasing scarcity. The U.S. agriculture industry, and therefore Congress and the taxpayers, are now suffering greatly because farmers believed that population growth would push up prices for food and increase demand and prices of farm land; former Secretary of Agriculture John Block is a prominent example. Many U.S. paper manufacturers came crying to the federal government for relief from contracts they bid on with the assumption that wood prices would rise, as the U.S. Department of Agriculture had foretold to them—on grounds that it was the government's responsibility because of its faulty forecasts. And so on.

Many of the young people in the Western world—I saw this most recently in a survey of high school students in Australia, of all places—have been thrown into despair by the belief that the world is running out of resources and must inevitably get poorer, a course supposedly exacerbated by selfish consumption in the countries they live in. Should we consider such spirit-destroying rhetoric as acceptable because it leads to a reduction some wish in the number of brown, black, yellow, and—yes—white human beings on the face of the earth, justified by the false belief that such a reduction has on balance positive economic effects? And should we assume no cost to the impact of false propaganda on public credibility and belief in the political process?

Those who call for aid to family planning have usually assumed that poor couples in poor countries do not have their fertility rates under reasonable control as a result of sensible decision making, and need guidance from Western population-planning experts. But couples tend to recognize that in the short run an additional person—whether a baby or an immigrant—inevitably means a lower standard of living for everyone. And the parents who carry almost all the burden, as well as the communities that also carry a small part of the burden, at some point say "enough," even while recognizing that more children would be good to have in the longer run.

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Parents in poor countries may overshoot, having more children than they would if they knew that the infant mortality rate had fallen as fast as it has, and that education is accessible but also expensive. If there were a superbeing who knew the present and future with perfect prescience, and also understood perfectly the preferences and feelings of each set of parents, perhaps such a superbeing could choose an "optimum" level of childbearing for each couple and country better than they will achieve by themselves. But such a superbeing does not exist. And to think that, say, the UNFPA is such a superbeing, and that its "recommendations"—always well circumscribed with pious statements about "voluntarism," "sovereignty," "individual human rights," and the like, but clearly intended to influence the practices of parents and countries—will be closer to such an "optimum" than will decisions arrived at independently by individual couples and countries, is both arrogant and ridiculous.

When fighting for foreign aid that goes beyond the simple provision of basic family planning services and includes persuasion and coercion, the population establishment resorts mainly to name-calling and associating their opponents with an administration they dislike. For example, commenting on a draft of the Reagan administration's Mexico City statement, former senators Taft and Tydings, "both affiliated with the Population Crisis Committee, decried the White House draft in a recent letter, saying that it would represent the adoption of a 'fundamentalist, know-nothing' political philosophy with respect to population and development in the less developed nations" (*Washington Post*, 14 June 1984, p. A3). Another example is a gratuitous casual remark in the midst of a book review on another topic by a senior staff member of the Population Council, one of the most dignified organizations in the population establishment: "The Reagan administration's confident expectation, expressed at the 1984 Mexico population conference, that government restraint (voluntary incapacitation?) will speed fertility decline by allowing market forces to shape and build the economy, here meets its match in simple-mindedness" (McNicholl 1986, p. 46).

Criteria for Giving Foreign Aid

What are reasonable grounds for giving foreign aid, or charity in general? Economics does not supply the criteria. "There is *no generally accepted economic rationale for foreign aid,*" wrote Schultz (1981, p. 124). And, in an essay labeled "a systematic reexamination of aid and its role in development," Anne Krueger (1986, p. 58) referred only to "the rationale for aid, 'aid effectiveness'—that is the

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degree to which different types of aid are conducive to accelerating development." Nor have I found a set of criteria in the literatures of other disciplines. Therefore, I hazard the following test: Charity is appropriate when the following conditions are present: First, *the recipient person or nation "needs" the help.* (The caveat here is that the presence of need is not always clearcut. The "need" of a bleeding child for medical assistance is not arguable, but the "need" of an unconverted person for religious salvation depends on the values and worldview of the potential giver.) Second, *the recipient wants the help.* Third, *the gift will not have bad effects* in the long run on the recipient or others. Fourth, *the charity will be used more-or-less efficiently* rather than largely wastefully or simply to obtain more money in a pyramid scheme. Fifth, *the charity will not produce hate toward the giver.* Let us test foreign aid to family planning against these criteria.

Do LDCs "Need" Family Planning Assistance?

In ordinary welfare programs, the criterion of need usually involves a means test. A person who owns a yacht is thought not to be an appropriate recipient for welfare, and a similar test might be applied to countries. In this spirit let us look at Table 6, which contains data on public expenditures for education, defense, and family planning in various countries, as well as public expenditures on family planning that include foreign donations, for those countries for which I could find data. In no case is the public expenditure for family planning, with or without foreign funds, more than a tiny fraction of spending for education. The implication is that if family planning is a high priority item, it is within the discretion of governments to redirect needed funding from other educational expenditures. Lest one worry about the social loss involved in shifting funds from other educational uses, in almost every case the large sizes of the "defense" budgets relative to the education budgets make clear that there is a pool of public expenditures into which countries could dip without causing social loss by reducing education expenditures. It would seem that the potential recipients own gunboats if not yachts, and therefore flunk the means test for charity.

Another standard criterion of need is that the good or service being provided be something that is thought by the giver to be of a nature that will improve the life of the recipient. Agricultural know-how has this nature. Birth-control capacity might be another. One might then wonder whether or not *individual* women and couples need assistance and have no way to pay for it, even if their governments could afford to provide it. Perhaps there are some such cases. But the actual

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TABLE 6

DEFENSE, EDUCATION, AND FAMILY PLANNING EXPENDITURES FOR 25 COUNTRIES

Country	Defense $/Person (Range 1978–81)	Education $/Person (Range 1978–81)	Family Planning Domestic $/Person (Most Recent Estimate)	Family Planning Foreign $/Person (Most Recent Estimate)	
Bangladesh	1–2	2	0.06	0.12	(1976)
Bolivia	27–34	29–35	0.00	0.02	(1977)
Brazil	14–17	61–64	0.00	0.05	(1985)
Colombia	9–16	21–34	0.13	0.13	(1983)
Dominican Rep.	17–23	19–26	0.18	0.20	(1977)
Egypt	61–78	25 (1977)	0.06	0.25	(1983)
El Salvador	16–28	23–30	1.25	0.38	(1980)
Ghana	13–26	33	0.13	0.02	(1977)
Hong Kong	n.a.	83–140	0.10	0.20	(1983)
India	6–7	7	0.46	0.06	(1983)
Indonesia	16–19	7–12	0.34	0.12	(1983)
Iran	202–456	75–198	0.92	0.00	(1977)
Kenya	10–16	21–24	0.15	0.39	(1978)
Korea, South	87–103	32–61	0.42	0.04	(1980)
Malaysia	54–102	108–117	0.60	0.19	(1980)
Mauritius	1–6	72–77	0.66	0.25	(1982)
Pakistan	16–17	5–6	0.12	0.10	(1979)
Philippines	14–16	12–13	0.25	0.18	(1983)
Rwanda	3–4	4–6	n.a.	n.a.	
Singapore	234–304	84–207	0.76	0.00	(1983)
Taiwan	n.a.	n.a.	0.33	0.00	(1983)
Tanzania	7–27	n.a.	0.00	0.03	(1976)
Thailand	24–28	17–28	0.18	0.09	(1983)
Tunisia	7–16	49–73	0.10	0.26	(1980)
Zimbabwe	16–57	28	0.25	0.00	(1978)

SOURCES: Defense per person: U.S. Arms Control and Disarmament Agency (1985, Table 1). Educational expenditure: United Nations Statistical Office, *Statistical Yearbook* (various years); United Nations Educational, Scientific, and Cultural Organization, *UNESCO Yearbook* (various years). Population: Nortman (editions 9–12). Family Planning Expenditures: Nortman (editions 9–12).

cost of contraceptive information and devices is exceedingly small (which is, incidentally, a major problem in commercial distribution). The funds devoted to "family planning" programs overwhelmingly are spent for things other than "hardware" and straightforward services. What is called "information" and "education," but which is to a considerable degree persuasion, accounts for a large proportion of

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the expenditures that actually reach the field. Often, it is forced upon societies by U.S. efforts; there is plenty of documentation of this in the recent book by Jacqueline Kasun (1986). The most startling occurrence was reported by Joseph Califano (in Kasun, p. 56):

> [President Lyndon Johnson] repeatedly rejected the unanimous pleas of his advisors from Secretary of State Dean Rusk to National Security Advisor Walt Rostow to ship wheat to the starving Indians during their 1966 famine. He demanded that the Indian government first agree to mount a massive birth control program. The Indians finally moved and Johnson released the wheat over a sufficiently extended period to make certain the birth control program was off the ground.

When reminded of such events, officials at AID routinely admit that they occurred in the past, but assert that the "present" policy would not allow them. However, that assertion has been made over and over again, each one implicitly giving the lie to the past ones. It is this propaganda that many proponents of family planning activities believe that people "need" (compare the quotation from the NAS report above). I consider this to be at best arguable rather than obvious. But I do not believe that to be against propaganda implies that one is against to true family-planning assistance.

Still, if a true family-planning program were to provide information and devices to some couples to whom they would not otherwise be available, this might be seen as filling a true social need. And the program might be viewed as passing this test.

Do the Potential Recipients Want the Assistance?

One test of whether people "want" something is whether they allocate their resources to that good. Table 6 does not indicate any massive allocation of countries' own funds to family planning.

But do not foreign politicians, and persons involved in family planning activities abroad, often express the desire for these funds? Of course they do. We must ask what these expressions mean, however. To a politician, any foreign dollar coming into the country is another dollar to allocate to one constituency or another, or even to be turned to personal use. (Does anyone doubt that some foreign aid dollars went to buy shoes for Imelda Marcos?) Therefore, more such dollars are always welcome. And for those who work for family-planning organizations, cutting aid funds breaks their rice bowl, and removes such perks as trips to Mexico City for a UNFPA conference.[3]

[3]Allegations about motives are difficult to substantiate and are often odious, and hence I seldom make them. But in this case there is a nice piece of substantiation. At the 1985 International Union for the Scientific Study of Population (IUSSP) conference in Flor-

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Does the Assistance Do Harm?

Economic thought contains few apparent contradictions. One such contradiction, however, is between the fundamental assumption (actually a definition) that an increase in assets ("endowment") increases welfare,[4] and the common-sense observation that giving gifts sometimes harms recipients in the long run by changing their attitudes and habits.[5]

Resolving the apparent contradiction requires the recognition that a person's propensity to exert effort is a function of that person's wealth (as well as of the opportunities facing him or her).[6] General foreign aid programs may have this ill effect on recipients by reducing their propensity to exert effort (for example, the compensation to the natives of Bikini and the payments to certain Native American tribes), but the funds for family planning assistance surely are too small to have this sort of ill effect.[7]

Another ill effect that may flow from foreign aid is damage to a key industry. The dumped food aid of P.L. #480 apparently damaged the

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ence, the chair and the past chair of the Population and Family Planning Section of the American Public Health Association (APHA) circulated a form "facilitating" IUSSP members to have a telex sent to their senators and congresspeople in opposition to the Kemp amendment, which was intended to prevent funds from going to any organization that "supports or participates in the management of a program of coercive abortion." The initiators attempted to "facilitate" the matter by providing the language for the telex and stated: "Your message, sent by telex, will be adapted by APHA to suit the Senate and House situations. . . . All you need do is put your *name, home address and zip code* on this sheet and place it in boxes being distributed for the purpose." The telex senders with whom I talked denied that the act of telexing might be influenced by the signers who wanted to keep funds flowing to such organizations as IUSSP, which finance a large part of the travel to the conference. He who pays the piper does *not* call the tune among IUSSP demographers, I was told. But the circulated form also said: "If you are willing for a telex to be sent in your name, *at no cost to you*. . . . " Clearly the persons who drafted the request thought that the tiny cost of the telex could affect people's propensity to telex their senators. And, if a handful of dollars for a telex—less than the cost of a cheap meal—could influence IUSSP members, is it unreasonable to think that thousands of dollars of travel money and/or grant funds might influence them, too?

[4]An example in the context of foreign aid: "Clearly, a recipient's potential welfare could always be increased by a grant" (Krueger 1986, p. 63).

[5]The famous mathematician Mark Kac wrote in his autobiography (1985, pp. 7–8): "My great-grandfather . . . amassed what in those days must have been a sizable fortune and at his death, sometime early in the century, he left every one of his eighty grandchildren enough money to relieve them of any need to work for a living. All of them, with the exception of my father, chose a life of idle leisure until the First World War, when their inheritance was wiped out."

[6]This is the subject of my latest book, *Effort, Opportunity, and Wealth* (Simon 1987).

[7]Doug Bandow (1985) made a similar point in his introduction to *U.S. Aid to the Developing World*, which contains much interesting discussion on the general subject of foreign aid.

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agricultures of India, Egypt, and South American nations by lowering prices and reducing incentives for farmers to produce crops (Schultz 1981 and citations therein). But again this sort of harm is not relevant to family planning assistance.

Foreign aid programs can also do damage by directing policymakers' attention away from the fundamental mechanism of economic growth, and away from the obstacles to growth that may exist in a society. This is the gravamen of Bauer's charge (1984, ch. 5) that the Pope and the proponents of a New International Economic Order caused people to dwell on envy and redistribution rather than on personal hard work together with societal changes that would promote liberty and enterprise. And here I think that concern about population growth, and for family planning programs that are intended to reduce population growth, have caused great damage.

For 25 years our institutions have misanalyzed such world development problems as starving children, illiteracy, pollution, supplies of natural resources, and slow growth. The World Bank, the State Department's Aid to International Development (AID), the United Nations Fund for Population Activities (UNFPA), and environmental organizations have asserted that the cause is population growth—the population "explosion" or "bomb" or "plague." This error has cost dearly. It has directed our attention away from the factor that we now know is central in a country's economic development: its economic and political system.

For a recent example, consider this sentence in the press release from the National Research Council about the NAS report: "[T]he recent widespread famine in Ethiopia and other African nations and similar food shortages in China during 1959–61 can be attributed in part to 'very badly functioning markets combined with rapid population growth.' " That sentence leaves a very different impression than a report that food shortages were caused by dictatorial governments that beggared farmers by appropriating their land and heavily taxing their output, together with denying them the right to move freely to wherever they wished to work and live. That sentence sounds as if "market failure" is being used to justify more government interference and control of the activity in question rather than calling for reduction in interference that would allow markets to function more effectively. And such a sentence in the press release contradicts statements in the report that properly emphasize the ill effects of food subsidies, credit market distortions, and even the property rights mentioned elsewhere in the release. Even worse, it suggests that attention be paid to population growth rather than to fighting tyranny and working for economic freedom.

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Another ill effect of foreign aid for population control is suggested by Alan Rufus Waters (1985, p. 3): "Foreign aid used for population activities gives enormous resources and control apparatus to the local administrative elite and thus sustains the authoritarian attitudes corrosive to the development process." This sort of effect is difficult to demonstrate statistically, but Waters's vantage point as former Chief Economist for the U.S. Agency for International Development (USAID) gives him credentials as an expert witness on the subject.[8]

I have my own candidate for the title of worst harm from foreign aid: the advice that goes along with it. The root of the damage lies in the idea that artful manipulation by clever economists is the way to produce economic development. International organizations such as the World Bank have finally realized that prices matter in influencing economic activity. And they have proceeded from this realization to the proposition that countries should "get the prices right." But for them this does not mean that markets should be allowed to set prices, but rather that governments should set the prices with the help of the World Bank and its expert economists. Warren Baum and Stokes Tolbert (1985, p. 51) provide the following summary of the Bank's attitude toward intervention:

> As to the appropriate level of prices, the basic principle, dictated by the need to make the most efficient use of the economy's resources, is that the price of any product should equal the marginal cost of producing the last unit sold. A free competitive market would achieve the desired result of bringing prices into line with marginal costs, thereby allocating resources efficiently. In the real world, however, market conditions nearly always diverge from the competitive ideal. Even where there is a high degree of competition, the results produced by the market are efficient only for a given distribution of income. They may, therefore, not be consonant with other objectives, such as greater equity or social justice. Governments can intervene to improve the distribution of income by such means as imposing taxes or providing subsidies. The price system, if it is functioning properly, will then help to establish an allocation of resources which again is broadly efficient, but with a greater degree of social justice. In general, the best results will be obtained when producers face prices based on efficiency criteria, with indirect taxes and subsidies applied to consumer prices to achieve social objectives.

Under the stewardship of Robert MacNamara and A. W. Clausen, the World Bank—along with USAID—has been the strongest force

[8]It is of some interest that other persons who have been involved in USAID activities have also come out strongly against programs of "family planning" aid. These include Peter Huessey, author of a Heritage Backgrounder, and Nicholas Demerath, who wrote *Birth Control and Foreign Policy* (1976).

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pushing population-control programs.[9] In the name of "getting the prices right," persons who work for the World Bank advise governments—backed by the threat that recipient countries could lose Bank funds—about the appropriate set of prices to stimulate production and generate economic growth. The "experts" at the Bank, in other words, substitute their judgments for the free market's most important function: automatically producing the prices that give the correct signals to producers. That is, the advisers at the Bank believe they know better than a freely operating market what the "right" prices should be. The implicit grounds for this belief, I would guess, are faith in their own cleverness and the assumption that markets will fail to do the job correctly.

This phenomenon particularly horrifies me because in the name of economics, these persons deny the birthright of Western economists since Mandeville, Hume, and Smith, of whom the present-day prophets are Hayek, Bauer, and Friedman—the vision of the hidden hand that spontaneously produces benign results which central planning cannot accomplish. And the continuation of this practice of advising countries about appropriate prices seems inexorable as long as organizations such as the World Bank exist and (inevitably) employ economists who must find something to do. Giving the advice that governments should stop interfering with markets does not require time-consuming and expensive research, with "missions" from Washington to the capitals of benighted poor countries. But advice to free up markets would render unnecessary many jobs, and therefore it has no chance of coming about as long as the World Bank exists.

The belief that population growth slows economic development is not a wrong but harmless idea. Rather, it has been the basis for inhumane programs of coercion and the denial of personal liberty in one of the most valued choices a family can make—the number of children that it wishes to bear and raise. Also, harm has been done to the United States as donor of foreign aid, over and beyond the funds themselves, by way of money laundered through international organizations that comes back to finance domestic population propaganda organizations, and so on (see Simon 1981, chaps. 21–22).

One of the reasons the population-bogey idea stays in currency is that this has been the rare issue upon which everyone in this ideo-

[9]Baum and Tolbert (1985, pp. 213, 217) provide the following up-to-date statement of the World Bank's policy position: "Rapid population growth slows development. . . . For population, the principal objective of most developing countries should be to slow the rate of growth."

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logically divided world could agree. I ran into this perverted amity not long ago at a meeting in India on population economics, which was attended by many employees of international agencies. During four days, there was not a single mention of the role of the economic system, whether market-directed or state-controlled. When I suggested that the subject should at least be aired, I was met by silence in the formal meeting and was told informally that the issue simply was outside the scope of attention. ("It's like talking about religion," someone said.)

What Kinds of Foreign Assistance Are Most Beneficial?

Lest the reader think that I am against any foreign aid in principle, a few unoriginal words seem in order about programs that can make economic sense. Agricultural research, including the organization and development of foreign agricultural research, has the great advantage that it puts no fungible funds or goods into the hands of bureaucrats, and causes no distortions in prices or other disruptions in markets. And the benefit/cost ratios have been calculated to be high. The provision of education in the United States to talented foreigners, especially if they are chosen by objective test, has many of the same advantages, as well as the advantage of making bright students familiar with the United States, and leaving them with impressions and ideas that they can take home with them. This also provides the opportunity for the United States to recruit valuable young persons of skill, energy, and imagination as temporary or permanent immigrants.

Conclusion

If we apply Hazlitt's central lesson on economics to the nexus of population growth and economic development, and take account of the indirect and lagged effects of economic freedom as well as the most obvious Malthusian effects that occur in the very short run, we can see that on net balance, additional persons being born are not a drag on progress in the long run. And foreign aid given for "family planning" programs may have more ill effects than good effects, and should not simply be viewed as a charitable act that improves the situation of poor people in poor countries.

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Is Population Growth the Dominant Force in Development?

D. Gale Johnson

Sometimes the best defense is a good offense. That seems to be an especially appropriate tactic when one attempts to respond to one who displays such certitude as Julian Simon. Thus I start my remarks with the following quotations from *The Ultimate Resource* (Simon 1981):

- When these important elements are included rather than excluded . . . and when reasonable assumptions are made about various dimensions of the LDC economy, the results are very different than they were with past models. The simulation indicates that a moderate population growth produces considerably better economic performance in the long run (120 to 180 years) than does a slower-growing population, though in the shorter run (up to 60 years) the slower-growing population performs slightly better. A declining population does very badly in the long run. And in the experiments with the "best" estimates of the parameters for a representative Asian LDC (the "base run"), moderate population growth has a better long-run performance than either fast population growth (doubling over 35 years or less) or slow population growth [p. 279].
- Using those parameters that seem most descriptive of LDCs today, the model suggests that very high birthrates and very low birthrates both result in lower long-run per-worker outputs . . . than do birthrates in between [p. 280].
- Perhaps the most important result of this simulation is that it shows there are some reasonable sets of conditions under which fairly high fertility has better economic performance at some times than does low fertility, but there are also other reasonable sets of conditions under which the opposite is true. . . . the results depend upon the choice of parameters with ranges that seem

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> quite acceptable. This implies that any model of population that concludes that any one fertility structure is unconditionally better or worse than another must be wrong. . . . The sole exception to this generalization is fertility below replacement [p. 291].

The final quotation of the three comes very close to the conclusions of the report of the National Academy of Sciences (NAS) on *Population Growth and Economic Development* (1986). The NAS report makes the case that the effects of population growth upon per capita real income depend on the economic, political, and social policies and institutions within which population grows. According to the report (NAS 1986, pp. 89–90):

> Population growth can, and often does, trigger market reactions. Many of these reactions move a country in a "modern" direction, that is toward better-defined property rights, larger integrated markets, more agricultural research, and so on. However, the market-induced adjustments to higher growth do not appear to be large enough to offset the negative effects on per capita income of higher ratios of labor to other factors of production. Nor is population growth necessary to achieve these forms of modernization: the fact that rates of return to agricultural research are already extremely high—in both developing and developed countries—implies that there is little need for additional stimulus from population growth; the evolution of property rights is stimulated by many factors—population growth being only one among them; and the scope of many markets can be enlarged by removing trade barriers. That these other devices exist does not imply a minimal role for population growth, but it does caution against advocacy of growth as the only way to achieve them.

It might be argued that the above three quotations from *The Ultimate Resource* are the conclusions from a model that was used to refute another model. At least Simon has so argued and that therefore the particular results should not be taken too seriously. But in his earlier book on *The Economics of Population Growth* Simon (1977, p. 474) concludes:

> In the context of LDC's: Moderate population growth leads in the long run to higher per-worker income than does a constant-size population *or* very fast population growth. . . . The optimum LDC population growth rate differs fairly widely with the positive growth range depending upon the parameters chosen, which suggests that no simple analytic model is acceptable and no single answer about the rate of population goals is reasonable.

Later in the context of explaining why his 1977 book arrives at conclusions that differ so sharply from mainstream population anal-

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ysis, he states three propositions about population growth in the LDCs (1977, p. 483):

- Population growth in LDC's produce many positive economic effects as well as negative effects.
- In LDC's, *some* population growth is beneficial in the long-run, as compared to *no* population growth.
- Over a wide range of "moderate" population growth rates of population growth in LDC's, the rate of population growth has a relatively small long-run effect upon per-worker income.

Perhaps Simon has revised his views over the past several years about the effects of population growth rates on economic development in the LDCs. But whether he has or not, I conclude that the differences between the major conclusions of the NAS report and those expressed in Simon's two books are relatively small. While Simon could take some comfort in the substantial narrowing of opinion on the effects of population growth, he apparently is unwilling to accept anything short of perfect agreement with his views. This is a mistake in my opinion, but obviously he is entitled to his own views.

An example is given in the NAS report of the possible effect of slowing the population growth rate by one percentage point per year. The example indicated that in 30 years per capita income would be increased by 16 percent compared to what it would have been with unchanged population growth. It was then noted that while this would be a significant gain "it would not be enough to vault a typical developing country into the ranks of developed countries" (p. 90). Over the same period if per capita income grew by 2 percent annually, per capita incomes would increase by 81 percent. There are numerous policy changes in an economy that could increase per capita income growth by 2.5 to 3 percent annually, resulting in income growth over three decades of 110 to 142 percent.

It is of some interest to note that the NAS report's conclusions are similar to those obtained by Simon from his models—for periods of 30 to 60 years, slower population growth results in higher per worker incomes than higher population growth rates. The report did not consider effects that extended for a century or two, which is how long it took Simon's model to generate significantly higher incomes from rapid than from slow population growth rates. But even over so long a period, he apparently found that moderate growth rates yielded the highest per worker incomes, higher than rapid population growth rates. So population growth rates do matter, even in the very long run.

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Personally I do not feel that any projection of outcomes of human behavior for a period of a century or more have any validity or merit any measure of belief. How many projections for as long as two decades or even one decade do you have confidence in? I know of very, very few. In his paper, Simon singled out projections of energy shortages and $3.00 gasoline as an example of projections that went astray. How can he be so sure his own models will not suffer the same fate from the passage of time, especially over such a long period of time?

The NAS report supports family planning efforts as a means of assisting families to achieve desired fertility levels. Simon (1987) agrees with this: "A couple's ability to have the family size the couple chooses is one of the great goods of human existence. And I am not in principle against a government's giving 'family planning' assistance to its own citizens or to citizens of another country if they so desire" (p. 173). But he hastens to add: "It does *not* follow from being in favor of informed, responsible parenthood that the United States should automatically give foreign aid to organizations that request funds in the name of 'family planning,' on the grounds that *some* good will be done by the funds even if they are largely wasted or used perversely" (p. 173). Would you support assistance for family planning under these conditions? I know I would not. But surely Simon must have something else in mind for him to make such a peculiar statement. I am not sure what it is.

Simon (p. 174) quotes with disfavor a sentence from the NAS report (1986, p. 93): "When a couple's childbearing decision imposes external costs on other families—in overexploitation of common resources, congestion of public services, or contribution to a socially undesirable distribution of income—a case may be made for policies that go 'beyond family planning.' " It may be noted first that the sentence does not state that the external effects of more children are negative. The closest the report comes to such a statement is that "these effects are likely to result in a negative external effect of childbearing in most developing countries." And, it is noted: "Current data and theory are inadequate to quantify the size of external effects; certainly, there is no evidence to suggest that drastic financial or legal restriction on childbearing are warranted" (NAS 1986, p. 84).

What neither the NAS report nor Simon has been able to do is to provide a generally accepted answer for how you compare the benefits of, say, lower per capita or per worker incomes from 2000 to 2010 to higher per capita incomes from 2110 and beyond. If we take present values and assume a real rate of interest of 2 percent, a dollar 20 years hence has a present value of $0.67 while a dollar 125 years

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from now has present value of just $0.084. Thus a dollar 20 years from now has a present value of nearly 8 times a dollar 125 years from now if the real rate of interest were 2 percent. Faster population growth, according to Simon, results in a lower per capita income in periods up to 30 to 60 years than does slower growth. Is the value of the lower income in the reasonably near future more than offset by the higher income many years in the future? I do not know. And who is to make the decision?

The relative importance of factors other than population growth rates in affecting economic development is illustrated by recent income changes in China. Population growth rates started to slow down in the early 1970s but it was not until the major rural policy reforms of 1979 that rural incomes started on an entirely new path. In just six years farm output increased by more than 50 percent, the production of all products by rural people by approximately 60 percent, and rural real income per capita probably doubled (NAS 1986, p. 89). Population growth rates, whether rapid or slow, could have had little effect in modifying these outcomes.

Simon uses the economic success of the densely populated city states of Hong Kong and Singapore to support his conclusion that population density has a positive effect on per capita income growth. But I believe a question that should be asked is whether the strong economic performance of these two states has been a development that could have occurred only during the middle part of the 20th century with an open world trading economy and the development of low cost ocean transportation.

And what do we say about Japan? Japan had a very slow rate of population growth from 1880 to date. It had a relatively slow rate of economic growth until 1960. True population density was quite high by world standards throughout the period. But the point I wish to emphasize is that even with a low rate of population growth, after 1960 Japan entered a period of rapid economic growth perhaps unparalleled in the history of the world. The density of population changed little from 1920 to 1960. A primary source of Japan's rapid growth after 1960 was the existence of an open trading world that Japan decided to participate in; during the 1950s it was inwardly oriented and grew slowly. Other factors, such as a high rate of saving, technological catching up, hard work, and the transfer of millions of workers out of an inefficient agriculture, made their positive contributions. But their effects would have been much more modest were it not for the reduction of barriers to trade so prevalent before World War II combined with the sharp decline in ocean transport costs.

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It is perhaps appropriate to note that the NAS report not only does not satisfy Simon but also fails to satisfy the "professional demographers" (as classified by Simon) or those in political positions who support international support of family planning efforts. Let me quote another evaluation of the NAS report (Demeny 1986):

> [T]he thinking epitomized by the NAS report gives us a construct with all the daring and charm of a Levittown house. It is distinctive chiefly in pronouncing the near irrelevance of rapid population growth to anything really important in development and development policy. The invisible hand wins here by default, with earnest gestures toward family planning programs as the sole right manifestation of statecraft in matters concerning population. I fear, however, that if the economic analysis *of* the report is accepted, the endorsement of family planning programs is hollow and will not long sustain political and financial support for them.

The quotations from *The Ultimate Resource* seem to me to contradict Simon's conclusion that "There is certainly no evidence here which suggests that population growth or density influences the rate of economic development" (p. 166). Which Julian Simon are we to believe, namely the one who says (a) that high rates of population growth (with high rates being defined as in excess of 2 percent per annum) as well as low rates have adverse effects on economic growth compared to moderate rates of economic growth, or (b) that population growth does not matter? (A slow rate of growth is less than 1.4 percent annually—doubling in 50 years.)

The World Bank (1984, pp. 254–55) gives estimates of the average annual growth of population for 34 of the 35 lowest income countries in the world (less than $400 GNP per capita in 1983) for 1965-73 and 1973-83. For the first period, 26 of the countries had population growth rates of 2 percent or more and for the second period, this was true of 29 of the countries. According to Simon's prior work it would appear that most of the very poorest countries have population growth rates that will have an adverse effect on economic development. And of the 37 middle-income economies, 34 had annual population growth rates in excess of 2 percent for 1973–83.

I have seen nothing to indicate that Simon has repudiated the models he developed in *The Economics of Population Growth* (1977) and summarized in *The Ultimate Resource* (1981). Thus are we to conclude that in most developing countries recent and current rates of population growth are too rapid and have adverse effects on economic growth and development?

I know of no better population policy than seeing that people have access to the information and means that are required for them to

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have the number of children that each family or couple desires. If this leads to a 1 percent, 2 percent, 3 percent, or a 0 percent population growth rate, so be it. Whatever effects population growth may have on economic development, the effects are relatively small within one or two generations, either plus or minus, compared to the effects of other variables such as the role of markets, the macro management of the economy, the openness of the country to international trade, and policital and social freedoms.

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Economic Atrophy in Black Africa

George B. N. Ayittey

Introduction

A palpable sense of despair, disillusionment, and indignation grips black Africa today. An increasing number of black Africans feel betrayed and outraged at Africa's execrable economic and political record. In 1978, Edem Kodjo, then Secretary-General of the Organization of African Unity (OAU), solemnly lamented before the African Heads of State gathered for an OAU summit "Our ancient continent . . . is now on the brink of disaster, hurtling towards the abyss of confrontation, caught in the grip of violence, sinking into the dark night of bloodshed and death" (quoted in Lamb 1985, p. xi).

Sadly, the situation has not improved. Africa today still teeters on the brink of a calamity, unimaginable in terms of its potential human toll. In 1985 alone more than two million Africans perished from famine, half of them in Ethiopia. Yet, paradoxically, Africa is immensely rich in natural resources. It has the largest reserve of untapped natural resources in the world and leads all other continents in hydro-electric potential.

There are 51 countries in Africa; 41 of them are south of the Sahara and are commonly called sub-Saharan or black Africa.[1] One would be hard-pressed to find a single economic success story in the entire region. Virtually all indices of economic progress have performed miserably since the 1960s, when black Africa gained its independence from colonial rule. In particular:

- Real income per capita has dropped by 14.6 percent for all of black Africa (see Table 1). Unadjusted for inflation, GNP per capita grew by a mere 1.4 percent in the 1960s and 0.5 percent

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[1]In this paper primary attention will be focused on black Africa. Although South Africa constitutes part of black Africa, it will be excluded from the discussion.

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in the 1970s. The 1980s began with declines in income per capita.

- Black Africa's population has grown at an annual rate of 3 percent, one of the highest in the world; Kenya has a population growth rate of 5 percent, the world's highest.
- Food production has not kept pace with the population explosion. Food production per person fell by 7 percent in the 1960s, 15 percent in the 1970s and has continued to deteriorate in the 1980s.
- Close to 45 percent of black Africa's food is now imported, despite the U.N. Food and Agriculture Organization's (FAO's) assertion that the Congo Basin alone can produce enough food to feed all of black Africa.

This paper investigates why things have gone so wrong in black Africa and proposes an alternative development model. Ever since the famine rudely thrust Africa onto the world's center stage, there has been no shortage of theories to explain black Africa's economic atrophy. The hypotheses range from inadequate aid and lack of capital to the absence of an entrepreneurial class and natural adversities to U.S. imperialism. Unfortunately, many of these theories are uninformed or peripheral and have little to do with Africa's retrogression.

It is not so much that black Africa lacks entrepreneurs or capital, nor is it that international aid agencies were excruciatingly lethargic or failed to do enough in black Africa. More than $80 billion has been pumped into the region since 1960; Tanzania alone received more than $3 billion in aid between 1972 and 1981. Rather, the cause of black Africa's cachexia lies elsewhere—in the political leadership. That leadership is a failure even by indigenous African standards, without relying on foreign criteria.

Why Black Africa Failed to Develop

In assessing the development record of a region, three pertinent elements need to be examined: (1) the structure of the development models or the theoretical supports upon which policies were based; (2) the manner in which the policies or the theoretical strictures were applied; and (3) the nature of the political leadership and its development policies.

Much as we would like to divorce economics from politics, the separation is often tenuous at best. Political instability engenders economic instability. The political leadership creates the milieu within which development occurs. The leadership may introduce policies and practices, extrinsic to development models, that inhibit growth.

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TABLE 1

REAL GNP PER CAPITA, AVERAGE ANNUAL GROWTH RATES, 1960–81

Country[a]	Growth Rate	Country	Growth Rate
Lesotho	7.0	Zimbabwe	1.0
Nigeria	3.5	Benin	0.6
Kenya	2.9	Central African Republic	0.4
Cameroon	2.8	Sierra Leone	0.4
Malawi	2.7	Guinea	0.2
Togoland	2.5	Zambia	0.0
Burundi	2.4	Zaire	−0.1
Ivory Coast	2.3	Somalia	−0.2
Tanzania	1.9	Sudan	−0.3
Rwanda	1.7	Senegal	−0.3
Ethiopia	1.4	Madagascar	−0.5
Mali	1.3	Uganda	−0.6
Liberia	1.2	Ghana	−1.1
Burkina Faso[b]	1.1	Niger	−1.6
People's Republic of Congo	1.0	Chad	−2.2

[a]Data were not reported for Angola, Mozambique, and the smaller countries, such as Sao Thome and Cape Verde Islands.
[b]Formerly Upper Volta.
SOURCE: World Bank, *World Development Report 1983*, Table 1, p. 148.

Corruption, capital flight, and kleptocracy—government by armed looters—may be such examples.

The Inherent Deficiency and Irrelevance of Orthodox Development Models

Development economics is replete with fundamentalist dogmas—capital, comprehensive planning, import substitution, and external aid fundamentalisms, to name a few (Yotoupoulos and Nugent 1976). These dogmas have helped to plunge the discipline into a state of paralysis, largely self-inflicted by its own profligate theories.[2] Notable among those few economists who mounted bold challenges to these dogmas was Peter T. Bauer.[3] His courageous and indefatigable

[2]This state of affairs is even conceded by some of the architects of the early development models. See, for example, Lewis (1984) and Hirschman (1980).

[3]See, for example, Bauer (1967, 1972, 1984). Others worthy of mention are Basil Yamey and Walter Ekan.

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efforts continue to offer an incipient ray of hope out of this dark wilderness.

The fundamental deficiency of orthodox development economics has been its inability to come to grips with the environment in which development proceeds. The process does not take place in a vacuum. Politics, cultural practices, social attitudes, and motivations all have as much to do with development as do increases in gross national product (GNP). Bauer (1972, pp. 313, 331) put it more succinctly:

> Abilities and attitudes, mores and institutions, cannot generally be quantified in an illuminating fashion. Yet these are major determinants of economic performance and thus of material progress. . . . [Nonetheless] the most influential publications of the consensus literature either ignore altogether people's capacities and motivations and the social institutions and mores which reflect them or greatly underestimate their significance. . . . [Consequently] the neglect of consensus literature of the non-quantifiable factors behind economic performance has lent an air of irrelevance and unreality to much of both theoretical and applied writing in this area.

A discipline that purports to have as its central objective the economic advancement of the people of the less developed countries (LDCs) must recognize two facts. First, peasants constitute the majority in any LDC. In addition, they produce the bulk of its real wealth: foodstuffs, cash crops, minerals, exports, and foreign exchange.

Logically, then, the peasants ought to be at the center of any development model or strategy; securing large surpluses from them is the key to economic prosperity. How these surpluses are produced, whether by "primitive" or "modern" techniques, is immaterial for a destitute and starving LDC.

The second fact that needs recognition is that the environment in which the peasants find themselves to a large extent conditions or determines their economic behavior as well as the size, or the lack thereof, of the surpluses they generate.

This environment is composed of two parts: (1) a traditional environment that delineates the peasants' indigenous value systems, attitudes, and motivations and (2) a national environment created by the government in power. In relative terms, the traditional environment is of greater importance, because illiterate people tend to go more by custom and age-old practices than by national policies they may not understand. The two "environments" often exist in a complementary or antithetical relationship. In general, when the national environment fails to make sense or clashes violently with the traditional, illiterate peasants tend to retreat into their traditional mold:

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rural life, self-sufficiency, and subsistence farming (see Ayittey 1986b, 1986c).

Devising a realistic development scheme or model would dictate taking some cognizance of this traditional environment and its inimitable features. For example, it would be highly ill-conceived to devise an agricultural scheme for black Africa that is directed from the capital city, has no role for the tribal chiefs (the caretakers of communally owned land), or envisages the employment of African peasants at a subsistence wage that allows the state or some private individual to reap all the profits. Such a scheme, no matter how well-intentioned, would be doomed in black Africa. In fact, many schemes have failed because they did not fit into the peasants' traditional culture or vocabulary. While African peasants only understood such indigenous esoterica as *abusa,* governments and experts were speaking foreign languages to them. In its 1981 report, the European Economic Community (EEC) stated: "Many development projects failed because they were on too large a scale and were not adapted to the population and environment they were supposed to benefit. . . . The Report cited agricultural complexes in Zaire which were still not viable 10 years after completion. The projects of lasting value are generally those which are simplest and directly benefit the local community concerned" (quoted in *West Africa,* 18 January 1982, p. 188).

In failing to explore or understand the peasants' traditional environment and its lexicon, orthodox development economics denied itself clues to the achievement of its central objective: how to coax large surpluses from the peasants and lift them out of poverty.[4]

The Unfortunate Consequences of Orthodoxy

Orthodox preoccupation with fundamentalist dogmas has helped spawn some rather irrational behavior. A tendency has developed to equate modernism and industrialization with development. Referred to as the "religion of development" (Uphoff and Illchman 1973, p. 13), its impact has been to create a mentality in both LDCs and developed countries (DCs) exhibiting the following features:

- The characteristics of underdevelopment have been misinterpreted as *causes* of economic "backwardness," or the characteristics have been so strongly identified with underdevelopment for development to mean their absence.

[4]Even the habitats and languages of baboons and whales are carefully studied by natural scientists before they attempt to relocate them or improve their welfare.

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- Negative imputations are directed at the characteristics as if there is something intrinsically inferior with agriculture, for example, as a means of livelihood.
- That which is "foreign," "modern," or "Western" is sanctified and that which is indigenous is castigated.
- There is impatience with the speed of development when "instant" results predicted by orthodox models are either not forthcoming or not coming fast enough.
- There is a general predisposition to look outside rather than inside territorial boundaries for economic salvation, and there is a sense of despair or helplessness when such salvation is not readily available in sufficient quantities.

The "religion of development," the credo of the elites of the LDCs, manifests itself in several ways. Children are herded into classrooms to improve a few literacy statistics. The economic landscape is dotted with a few spectacular "hot-houses" with little regard to capacity utilization. Whole populations are exhorted to change their attitudes and ways of life and adopt foreign ones. In Africa, civilians queue for long hours in the hot sun to obtain such commodities as imported cube sugar, polished rice, and tinned milk, forgoing the local substitutes of granulated sugar and brown rice and ignoring the fact that most black Africans do not produce lactase, which is needed for the digestion of milk. Foreign exchange is wasted on show projects (skyscrapers in the middle of nowhere, airlines with half-empty seats, and shipping lines), either as proud symbols of national sovereignty or to prove to the world that an LDC is "developed." Tractors and other sophisticated agricultural equipment are imported wholesale and given to peasant farmers just to prove that agriculture is being "modernized" or "mechanized."

The "religion of development" underlies much of the warped sense of priorities that is evident in many parts of the Third World. For example, why would an LDC attach significance to the detonation of a nuclear device or to shiny modern equipment when large segments of its population do not have enough to eat.

Tragically, this religion has implanted a peculiar and rigid notion of development that perverts the development process itself. As Uphoff and Illchman (1973, p. 23) put it: "Orthodoxy drives out innovation; it makes for an unwillingness to form unusual alliances to pursue unorthodox policies or pursue orthodox ones in novel sequences. In promoting development, persons previously judged to be 'sinners' need sometimes to be treated as 'saints' and vice versa."

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A more alarming consequence of orthodoxy is the accumulating evidence that some of its own prescriptions impede rather than accelerate development—an anomaly that may be called "development misfeasance."[5] Substantial evidence exists in black Africa to suggest that some of the region's current development problems may be iatrogenic or expert-induced. Functional illiteracy, malnutrition, population explosion, and desertification of arable land are notable examples (see Ayittey 1986b, 1986c).

The Nature of the Development Policies Pursued in Black Africa

Although some of the policies adopted to develop black Africa derived their support from modern development theories, most were shaped by the idiosyncracies of black African leaders. As Lamb (1985, p. 65) observed: "Perhaps nowhere in the world do individual countries mirror the character of their presidents as much as in Africa. What a country is often depends solely on who the president is. A new man takes over and the country may move in an entirely different direction." Although there were differences among individuals, the policies that black African leaders adopted exhibited a remarkable degree of similarity.

Misguided Development Policies

Denigration of Africans and their traditions was a common feature of colonialism, and references to Africans as "primitive" and "backward" punctuated scholarly work. To the elites of Africa, westernization offered a way to gain acceptance or equality (Hagen 1962; Lloyd 1964). African elites wore western clothes, spoke western languages, drove western cars, and talked about western art and culture. They believed that in westernizing themselves their disparagement at the hands of the colonialists would ease. This psychological response mechanism is known as "identification with the aggressor" (Hagen 1962). The victim (African elites) had a tendency to mimic the external traits of the aggressor (the colonialists).

After independence, the object of westernization shifted more toward gaining international acceptance and equality for the new nation (Lloyd 1964). Foreign metropolitan symbols were subsequently mimicked. London had double-decker buses; so must Africa. American farmers used tractors and pesticides; so must Africa. In 1963, President Nkrumah of Ghana demanded a bylaw requiring that all advertisements in Accra, the capital city, be illuminated by neon

[5]The phraseology is intended to suggest that the pursuit of orthodox policies to promote development may create new situations inimical to further development (Ayittey 1981).

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lighting so that the main streets of the city would resemble Piccadilly Circus (Werlin 1973, p. 71). When Sir Arthur Lewis pointed out to an African prime minister that he was proposing to spend 50 percent of his entire development budget on his capital city, which had only 5 percent of the population, the prime minister was surprised. "But why not?" he asked. "Surely when you think of England you think of London, when you think of Russia you think of Moscow and when you think of France you think of Paris" (Lewis 1962, p. 75). The most bizarre instance of this "so-too-must-we" syndrome occurred in 1976 when President Bokassa spent 20 percent of the GNP of the Central African Republic ($20 million) to crown himself "emperor" to prove that, like France, black Africa can produce emperors.

Faith in the religion of development was easily won because African leaders themselves were already predisposed toward or preoccupied with signs of modernism and an unimaginative aping of foreign metropolitan capitals. Of all the black African leaders, perhaps none embraced this peculiar brand of African elitism more than the late Dr. Kwame Nkrumah, the first black African president of Ghana. Nkrumah set the stage for the rest of black Africa; his radical ideas were much admired and emulated in many African countries. Of the 41 black African countries, only 4 (Cameroon, Ivory Coast, Malawi, and Senegal) chose more enlightened market-oriented economic policies.

When Ghana gained its independence on March 6, 1957, Nkrumah (1973, p. 190) declared socialism as his ideology: [My] Convention People's Party is the state and the state is the Party. . . . The Party has always proclaimed socialism as the objective of our social, industrial and economic programs. Socialism, however, will continue to remain a slogan until industrialization is achieved."

His reasons for choosing socialism are scattered in various government documents and in his own writings:

> The choice is based on the belief that only a socialist form of society can assure Ghana of a rapid rate of economic progress without destroying that social justice, that freedom and equality, which are a central feature of our traditional way of life [*Seven-Year Development Plan* 1963, p. 1].
>
> Socialist transformation would eradicate completely the colonial structure of our economy [Nkrumah 1973, p. 189].
>
> Under colonial rule, foreign monopoly interest had tied up our whole economy to suit themselves. We had not a single industry. Our economy depended on one cash crop, cocoa. Although our output of cocoa is the largest in the world, there was not a single cocoa processing factory. There was no direct rail link between Accra and Takoradi. There were few hospitals, schools and clinics.

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> Most of the villages lacked piped water supply. In fact, the nakedness of the land when my government began in 1957 has to have been experienced to be believed [Nkrumah 1973, p. 395].

Nkrumah was haunted by the specter of imperialism and neo-colonialism, which "is only the old colonialism with a facade of African stooges." He believed that only socialism could effectively check their evil machinations.

Nkrumah's socialist transformation of Ghana was to be rapid in order "to achieve in a decade what it took others a century." There was to be a rapid expansion of the state sector and "various state corporations and enterprises were to be established as a means of securing our economic independence and assisting in the national control of the economy" (Nkrumah 1957, pp. 398–99). "Capitalism is too complicated a system for a newly independent state; hence, the need for a socialist society" (Nkrumah 1957, pp. xv–xvi). Nkrumah spurned the efficacy of the market mechanism in inducing the rapid economic development he was determined to achieve. Planning was to be the tool, because "government interference in all matters affecting economic growth in the LDCs is today a universally accepted principle" (Nkrumah 1963, p. 109).

Nkrumah understood the adopted socialist philosophy as increasing the participation of the state in production and distribution, and this philosophy was central to his economic strategy. State participation as a domestic policy was to be pursued toward "the complete ownership of the economy by the state."

A wide variety of instruments was employed to assure state participation and regulation of the economy. Numerous state enterprises were set up and legislative controls were placed on imports, capital transfers, industry, rights and powers of trade unions, prices, wages, interest, and rents. The government's share of gross capital formation rose from 25 percent to over 65 percent (*Economic Survey of Ghana* 1969). There was a massive transfer of investable resources to the state, with the emphasis on industry. Nkrumah (1957, p. 7) noted:

> Industry rather than agriculture is the means by which rapid improvement in Africa's living standards is possible. There are, however, imperial specialists and apologists who urge the LDCs to concentrate on agriculture and leave industrialization for some later time when their population shall be well fed. The world's economic development, however, shows that it is only with advance industrialization that it has been possible to raise the nutritional level of the people by raising their levels of income.

The strategy on industrialization was import substitution (I-S) and state ownership. High tariff walls were erected to protect the I-S

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industries that were expected to conserve foreign exchange by replacing goods previously imported. Securing a domestic market for the I-S industries and assuring a ready supply of imported inputs was one of the objectives of the import-licensing program.

The peasants, the chiefs, or the indigenous sector generally did not fit into the religion of development nor into the grandiose plans Nkrumah drew up to industrialize Ghana. His *Seven-Year Development Plan* (1963–69), for example, devoted only two paragraphs to the agricultural sector, and the 1965 foreign exchange budget allocated a mere $2 million to agriculture, compared to $114 million and $312 million for manufacturing and imports. Elsewhere in black Africa, Nigeria allocated only 6.5 percent of federal spending to agriculture, and in Benin's current *Ten-Year Development Plan* (1980–90) only 5.8 percent of total planned expenditures is earmarked for agriculture.[6]

When Nkrumah belatedly recognized the immense contribution that agriculture could make to the country's economic development, he took his socialist program of state participation to that sector as well. The indigenous agricultural sector, however, was skirted in a somewhat dysfunctional perspicacity of the logistics of local food production. Nkrumah believed that he could not rely on peasant farmers for a rapid agricultural revolution because they were "too slow to adapt or change their practices to modern mechanized scientific methods" (Uphoff 1970, p. 602). Nkrumah saw mechanization and socialization as the quickest way to achieve an agricultural transformation.

The State Farms Corporation, Workers' Brigade, and Young Farmers League were assigned the major task of creating "a complete revolution in agriculture on our continent [and] a total break with primitive methods and organization and with the colonial past" (Nkrumah 1963, p. 27). The State Farms Corporation was to be a model of collective agriculture; the Workers' Brigade was to run settlement farms; mechanization was to be the guiding principle for the Young Farmers; and a Food Marketing Board was created to fix maximum prices for all foodstuffs and to improve the efficiency of the distributive system. After its establishment in 1962, the State Farms Corporation expanded its operations rapidly. By 1964, 51,226 acres were under cultivation; by 1965, 105 farms were being operated

[6]Colonization also contributed to the neglect of agriculture. The colonies were envisaged as purveyors of food and raw materials, and development of agriculture after independence was seen by African leaders as an unacceptable return to the old colonial relationship.

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with a labor force of over 30,000 (Wheetham and Currie 1967, p. 174).[7]

The Results of Nkrumah's Socialist Experiment

Nkrumah's socialist experiment and big-push investment strategy were fiascoes. The state enterprises, established to produce formerly imported consumer goods, were hopelessly inefficient. Despite excessively high, effective rates of protection, these enterprises were saddled with chronic excess capacity and attendant high production costs.[8] In 1968, imported raw materials comprised a weighted average of 74 percent of total inputs (Killick 1978, p. 201), but in many cases the finished products were more expensive than their imported substitutes.[9] Underutilization was extensive during the 1960s:

> The government of Ghana estimated that at the end of 1966 actual manufacturing was only one-fifth of the single-shift capacity of installed plant [*Ghana's Economy and Aid Requirements*, Government Report, 1968].
>
> Of the 20 state manufacturing enterprises in operation in 1964, only 10 were working to half their optimum capacity. In three cases, the actual production was less than 10 percent of full capacity. In one case (the Paper Bag Division of the Paper Conversion Corporation at Takoradi), the rate of utilization was 3.5 percent [Ahmad 1970, p. 116]. In another case (the State Sugar Factory at Asutsuare), a mere 3 percent of capacity was achieved [Killick 1978, p. 224].

As Steel (1972, p. 226) observed: "Existing structure and utilization of manufacturing capacity represents a very costly and inefficient method of gaining foreign exchange and raising national income. Even worse, 24 percent of output was produced at a net loss in foreign exchange, taking into account all foreign exchange costs of capital and domestically produced inputs."[10]

At the time of the military coup in 1966, only 3 or 4 of the 64 state enterprises were paying their way (Garlick 1971, p. 141). Unprofitable state enterprises included the State Fishing Corporation, the

[7]On February 6, 1966, Nkrumah's government was overthrown by a military putsch.

[8]Leith (1974) estimated the effective rate of protection at just over 100 percent on groundnut oil and coffee huskling, over 300 percent on records, over 400 percent on radio and TV assembly, over 700 percent on apparel, and over 1,000 percent on shoes and cosmetics.

[9]For example, in industries producing cocoa butter, distillery products, handbags, luggage, and paints (Leith 1974, p. 74).

[10]Killick (1978, p. 197) found that between 1966 and 1978, when imported raw materials rose by nearly 50 percent, gross output per manufacturing establishment actually declined in real terms by 9 percent.

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State Footwear Corporation, the State Transport Corporation, and the State Housing Corporation. Killick (1978, p. 227) summed up the situation:

> State enterprises were unprofitable—absolutely by comparison with public enterprises in other developing countries and by comparison with private enterprise in Ghana—and they were unprofitable despite considerable monopoly powers [and excessive effective rates of protection]. . . . State enterprises, then, failed to fill the entrepreneurial gap, to propel the economy forward and to generate the surpluses which Nkrumah demanded of them.

The results of collectivization in the agricultural sector were abysmally poor. For example, in 1970—despite having many of the Ministry of Agriculture's professional officers, ready access to capital and technical know-how, favorable allocation of import licenses, and governmental support—State Farms achieved lower yields than their peasant counterparts (0.21 tons per acre versus 0.94) and smaller output per worker (0.59 versus 3.33). In 1964, the State Farm Corporation was cultivating only 3.3 acres per worker, compared to 5.1 acres per peasant farmer (Killick 1978, p. 193). After only three years of operation, the State Farm Corporation had accumulated a net deficit of ¢17,248,784 by the end of 1965 (Levine 1975, p. 34). The failure of the State Farm Corporation was recognized even in official circles. A Ghana governmental report (the *Abrahams Report* 1965, p. 23) noted, "State Farms . . . have not produced foodstuffs in sufficient quantities to justify their capital and current investment." In 1965 the World Bank Mission to Ghana concluded that neither the State Farms nor the Workers' Brigade

> had had success in achieving either its aim of significantly improving agricultural production or of attaining financial self-sufficiency. Indications are that workers of both agencies produce little more, if as much, as they and their families consume and that if engaged in traditional agriculture they would produce significantly greater quantities of farm produce at a much lower cost.[11]

The black African countries that followed closely in Nkrumah's footsteps were Guinea, Mali, the People's Republic of Congo, Tanzania, and Zambia. The socialist experiments in agriculture were resounding failures in those countries as well. More recently Angola, Mozambique, Ethiopia, and Guinea-Bissau have taken to Nkrumah's socialist path.

[11]Quoted in Killick (1978, p. 194). This may be called "mechanized subsistence agriculture."

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Beginning in the late 1960s, military coups swept across Africa, ousting civilian governments amid charges of corruption and economic mismanagement. To combat the takeovers, the military governments in Ghana, Burkina Faso, Togo, Benin, Nigeria, Zaire, and Uganda oddly sought more, rather than fewer, state controls. None had the sense to realize that state controls breed corruption, inefficiency, and mismanagement. Successive governments after Nkrumah, for example, retained the unwieldy state interventionist machinery he had instituted.[12] Inevitably, the results were greater inefficiency, excess capacity, and economic retrogression. For example:

> In 1972, the government took over the African Timber and Plywood Company. Before the take-over, "production was 75 percent of installed capacity but this has fallen to a woeful 13 percent" [*West Africa*, 12 October 1981, p. 2422].
>
> In 1976, the government of Ghana took over R. T. Briscoe, a foreign company. "Before the take-over, the company was producing 241 buses in 1974. After the take-over, production was 12 buses in 1977 and only 6 buses in 1978" [*Graphic*, 18 January 1979].
>
> In 1980, the government of Ghana voted ¢80 million for the Ghana National Reconstruction Corps, a reconstituted State Farm Organization. At the end of the farming season, only ¢864,0000 was recovered [*Graphic*, 21 July 1981, p. 5].
>
> For 14 months, from November 1978 to January 1980, the State Jute Bag Factory was closed due to a shortage of raw materials. Yet, the 1,000 workers received full pay for the entire period of closure [*Punch*, 14–20 August 1981, p. 4].
>
> The pre-fab factory started by the Russians in 1962 has not produced a single home. Yet, 500 Ghanaian workers and 13 Soviet experts were drawing salaries for a period of 6 years [*Graphic*, 6 December 1978, p. 5].

The continuation of Nkrumah's misguided policies was most marked in the attempts by successive Ghanaian governments to battle inflation. When food shortages appeared in 1963–64 and prices of local foodstuffs began to soar, the Nkrumah government reacted with palpable paranoia, blaming food traders and "their neo-colonial collaborators" and looking for an imperialist conspiracy. The government imposed price controls on the traders instead of looking at production and the government's own inflationary policies.

The basic cause of inflation in Ghana, and elsewhere in black Africa, has been mounting budget deficits and printing more money

[12]The Busia government, 1969–72, made feeble attempts to sell nonviable state enterprises but buckled under pressure from vested interest groups.

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to finance them.[13] Indeed, one Ghana head of state (Acheampong) recognized that "In the battle against inflation, one main weapon must be the control of government expenditure itself. Recourse to the Central Bank to support the Budget and the consequent very high level of monetary expansion in recent years must be halted" (*West Africa,* 15 August 1977, p. 1658).

The governor of the Bank of Ghana also noted that "budget deficits have been the major source of inflation in the past 3 years, 1974–77" (*West Africa,* 19 December 1977, p. 2583). And the 1978/79 *Government Budget Statement* (p. 2) admitted, "Analysis of the changes in the money supply shows that as the size of the budget deficit continued to expand so did Government borrowing from the Bank of Ghana. Furthermore, over the past 5 years, more than 70 percent of every budget deficit has been financed by the Bank of Ghana, resulting in the injection of substantial amounts of new money into the economy."

The currency over-issue itself was fraught with graft and venality. As an article in *West Africa* (14 December 1981, p. 3014) observed: "Top officials of the PNP Administration are alleged to have received £2.7 million (pounds sterling) commission on a ¢7 billion currency printing contract awarded to British firms." In this environment inflation soared. By December 31, 1981, inflation was running at 116 percent (*Graphic,* 10 December 1982, p. 1). Again, imperialist conspirators and capitalistic traders were blamed by government officials for the inflation. Consequently, stringent price controls were imposed on traders and ruthlessly enforced.

> In June 1980, a magistrate, Mr. Kwadwo Asumadu-Amoah, jailed a 43-year-old petty trader, Madam Abena Amponsah, for three years at hard labor for making an illegal profit of $1.50 on 6 cakes of "Guardian" soap. The same magistrate handed down a three-year term at hard labor to an 18-year-old boy who made an illegal profit of fifty cents on a packet of matches [*Graphic,* 5 June 1980, p. 5].
>
> In January 1982, Air Force personnel destroyed over 400 tables and chairs belonging to traders at Apampam Store in Takoradi Central Market in a bid to enforce price controls [*West Africa,* 1 February 1982, p. 286].
>
> In February 1982, the PNDC Secretary for the Upper Region, Dr. Awdu Tinorgah, ordered a detachment of the Police Striking Force to enforce price controls, following the refusal of traders at the Bolgatanga Market to sell their items at controlled prices [*West Africa,* 26 April 1982, p. 1170].

[13]Ayittey (1981) found that for the period 1957–74, a 10 percent increase in Ghana's money supply raised domestic prices by 9.8 percent.

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> Markets were burned down and destroyed at Accra, Kumasi, Koforidua, and other cities when traders refused to sell at government-dictated prices. In February 1982, the Tamale Central Market was set ablaze, causing the destruction of large quantities of foodstuffs, drugs, and imported spare parts. Then John Ndeburge, the Northern Regional Secretary, set up a five-member committee of inquiry to investigate the circumstances leading to the incineration of the market [*West Africa*, 8 March 1982, p. 684].

The relatively little food that there was in Ghana was being destroyed. A market survey done by the government-owned newspaper *Graphic* showed that "the market traders in Cape Coast would rather withdraw their goods than bring prices down" (*West Africa*, 25 January 1982, p. 272). The authorities responded by wreaking more destruction "as a warning to traders who had decided to withdraw their wares instead of reducing prices" (*West Africa*, 1 February 1982, p. 286). When that failed to intimidate the market traders, the military government launched house-to-house searches for goods (*West Africa*, 15 February 1982, p. 481).

These policies were continued for the rest of 1982 and 1983. Price Control Tribunals were set up to hand down even more stringent penalties:

> The Brong-Ahafo Tribunal imposed a ¢12,000 fine on Grace Lamiere, a popular baker in Sunyani, for buying a bag of flour *above* the controlled price at Gonnorkrom. . . . The Tribunal had earlier jailed Dora Mensah, also a baker, for 6 months and fined her ¢5,000 for exchanging cedis on the black market [*Ghanaian Times*, 22 June 1982, p. 8].
>
> An Accra trader, Umaro Shaibu, was jailed 4 years by the Price Control Tribunal in Accra for selling a bottle of "Sprite" for ¢7 instead of ¢1.50 [*West Africa*, 28 February 1983, p. 576].
>
> On March 11, 1983, at the Kumasi Central Market, a pregnant woman, Yaa Amponsah, had her 18-month baby flung to the ground and she herself slapped and kicked by a policeman who insisted on paying $1 instead $5 for two tubers of yam. At the same market, another pregnant woman was dragged on the ground by soldiers for allegedly selling above the controlled price, causing her to miscarry the next day [*West Africa*, 20 March 1983, p. 487].

For all their faults, the British colonialists seldom perpetrated such heinous atrocities against Ghanaian peasants. Nor do even "backward" tribal chiefs against their peasants. The results of these inanities? Between January 1982 and April 1983, prices of locally produced goods rose by more than 600 percent. The price of a bag of maize, for example, went from ¢500 in January 1982 to ¢4,000 in April 1983; and for nine months, bread disappeared completely from the

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markets (*West Africa,* 11 July 1983, p. 1597). The government of Ghana could not even feed the food traders it had jailed for allegedly selling or buying above government-fixed prices. Thirty prisoners died in Sunyani prison for lack of food; 39 inmates died at another (*West Africa,* 15 July 1983, p. 1634). For the economy as a whole, "GNP per capita declined from $483 in 1979 to $447 in 1981 while by 1983 living standards had fallen steadily to some 16 percent of 1972 levels. The Urban Consumer Price Index (1977 = 100) averaged 363 in 1980, 800 in 1981, 976 in 1982 and by May 1983 was at 2,222.6" (*West Africa,* 19 March 1984, p. 618).

Elsewhere in black Africa, virtually all of the African nations continue to pursue Nkrumah-type statist policies of centralization, state enterprises, and price controls. The results have been economic ruin:

> Across Africa, individuals and nations are sliding backward at an unprecedented speed. Experts warn of a coming disaster larger than anything the world has yet seen. . . . "If Burkina Faso is 5 percent worse off in 10 years instead of 15 percent, that would be an accomplishment," says one expert [*Wall Street Journal,* 15 July 1985, p. 1].

Cameroon, Ivory Coast, Malawi, and Senegal adopted free market policies. Only Ivory Coast achieved what may be called "spectacular" growth, but then Ivory Coast and Senegal are the biggest aid receivers on the continent. Senegal alone receives more than $500 million a year from the IMF, World Bank, and France—almost $100 per person. "Without that aid Senegal would be considered one of the region's basket cases," said the *Wall Street Journal* (29 July 1985, p. 18). Moreover, according to West Africa (10 February 1986, p. 282): "In 1973–1983, Senegal's GNP rose by an average of 2.6 percent from only 1.6 percent in 1965–70. But in 1984, it dropped by 4 percent in real terms to some $2,400 million. From 1965 to 1983, GNP per capita dropped by an annual average of about 0.4 percent."

One common characteristic of Cameroon, Ivory Coast, Malawi, and Senegal is the autocratic nature of their political systems. Senghor ruled Senegal for 20 years before handing the government over to a hand-picked successor, Diouf. Houphouet-Boigny has ruled Ivory Coast for 26 years. Hastings Banda has ruled Malawi for 22 years. In the January 14, 1984, presidential "elections" in Cameroon, President Biya won by 99.98 percent of the vote; he was the only candidate.

Senegal represents a black African country that failed to develop in spite of free market policies because its political leadership was lax, its state bureaucracy was out of control, and the country exploited its peasants. "Peasants, through their religious leaders, said ONCAD, the state monopoly peanut buying agency in Senegal, distributed

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poor seeds, unless bribed, under-weighed crops and generally 'creamed' farmers' profits in its role of intermediary between the farmers and Dakar" (*West Africa*, 1 March 1982, p. 573).

Ivory Coast's "spectacular" growth rests on rather shaky political grounds. Its development is very lopsided, concentrated heavily in urban areas, especially Abidjan. Furthermore, there are so many French nationals and other foreign personnel that Ivorians are increasingly becoming resentful, charging that their indigenous African traditions are in danger of being annihilated under "cultural imperialism."

In Malawi, the Kamuzo Academy and Kamuzo Hospital that President Banda built and named after himself do not employ blacks as teachers and doctors. The staff is drawn mainly from British expatriates. According to this black African President, blacks are not good enough.

Reasons for the Failure of Black African Government Policies

Multiplicity of Economic Objectives and Subordination to Noneconomic Aims

African leaders have too often pursued multiple and ill-defined policy objectives and subordinated economic policy to political aims whenever conflicts arose. Nkrumah's *Seven-Year Development Plan*, for example, had more than 13 objectives, ranging from attaining economic independence and social justice to African unity and "breaking the stranglehold of neo-colonialism." State enterprises are often expected to achieve noneconomic goals and are subject to all kinds of political interferences. Many are over-staffed with political functionaries and cronies:

> The [Ghana] State Shipping Line, Black Star Line, had so many redundant staff that 254 employees have been paid since 1981 for simply staying home [*West Africa*, 6 August 1984, p. 1607].
>
> In 1984, 20 percent of Ghana's public sector workforce was declared redundant by the Secretary of Finance [*West Africa*, 27 January 1986, p. 178].
>
> In Zambia, a country with critical shortages [of tires and auto spare parts, for instance] China is busy building a giant new headquarters for the country's only political party [*Wall Street Journal*, 29 July 1985, p. 18].

Administrative Ineptitude

Some of the reasons for the poor performance of Africa's state enterprises and development projects were poor project planning,

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lack of feasibility studies, improper siting of industries or projects, poor coordination, and implementation that emanated from defective administrative machineries:

> A Yugoslav company, which undertook the feasibility study itself, built a mango-canning plant in Ghana with a capacity exceeding the entire world's trade in mangoes. However, there was no local market for canned mangoes and when the state-owned factory was asked in 1966 to process 7,000 tons of mangoes, it was discovered that the mango supply in the area came from a few trees scattered in the bush [Ayittey 1984].
>
> The State-owned Sugar factory at Komenda in Ghana stood idle for more than a year after completion because it lacked a water supply system [Killick 1978, p. 231].
>
> Togoland built an oil refinery big enough to serve half a dozen West African countries. But Togo doesn't produce any oil. . . . The refinery sits idle under coconut trees. A costly double-decked suspension bridge was built over the Congo River in Zaire. One level is for a railroad that doesn't exist [*Wall Street Journal*, 15 July 1985, p. 1].
>
> The U.S. built 50 crop storage depots in Senegal and placed them in locations the peasants never visited. . . . In Uganda, a railroad expert discovered to his amazement that a repair shop built with foreign aid was seven times as large as the one he ran in Germany. . . . A fifth of Ivory Coast's foreign borrowing went to build two sugar mills that started production just four years ago and now are closed. . . . In Sudan, the Soviets built a milk bottling plant at Babanusa. Babanusa's Baggara tribesmen drink their milk straight from the cow and there aren't any facilities to ship milk out of Babanusa. The 20-year-old plant hasn't produced a single bottle of milk [*Wall Street Journal* 29 July 1985, p. 18].
>
> In Uganda and Angola, some high-rises lack glass panes and running water. In 1975, Canada built a $2.5 million semi-automated bakery in Dar-es-Salaam, Tanzania, but often there is no flour to make bread. . . . A Soviet-built cement factory at Diamou, Mali, was designed for a capacity of 50,000 tons a year. Beset by regular breakdowns, it produced 5 tons last year [*Time,* 16 January 1984, p. 27].

Lest one be inclined to ascribe these failures to a "lack of administrative skills," note should be taken of an observation made by the World Bank in reference to Ghana's State Farm Corporation: "The most simple calculation of costs and returns would have indicated the lack of viability in many of the Corporation's projects prior to their implementation" (quoted in Killick 1978, p. 230). This observation applies with equal force to many of the development projects launched in black Africa.

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Venal Tendencies

African governments are characterized by overspending, wasteful practices, willful extravagance with public funds, and financial irregularities and profligacies. Many projects failed in black Africa because they were riddled with graft and corruption. According to the World Bank's 1983 *World Development Report* (p. 117):

> Corruption seriously undermines the effectiveness of government. Over time, corruption tends to corrode popular confidence in public institutions. "Rent-seeking can become an obsessive pre-occupation. Public officials will do nothing without bribes and many people are unproductively employed in securing their favors or buying their silence. Corruption tends to favor those with economic or institutional power. Some corruption is on such a scale that it has major economic consequences; it may stimulate the illegal export of capital or result in large projects being awarded to contractors (often multinational companies) according to the size of their bribes rather than the quality of their performance.

Corruption undermines the efficiency of the civil service, impairing the government's ability to formulate and implement development policies. The import control program, for example, required licenses or official permission before goods could be imported. But in Ghana, corruption wreaked such havoc with the program that, more often than not, "imports were quite out of control" (Killick 1978, p. 269). The government was well aware of the program's failure and established four Commissions of Enquiry, all of which documented many cases of corruption.[14] In particular, the *Ollennu Report* (1966, p. 22) concluded that, besides government institutions, corporations, and enterprises, "import licences were granted, (a) upon contacts made with the Minister of Trade, or (b) upon payment of bribes. Those who had no contacts got nothing; those who had contacts and who had contacts made for them but would not or could not pay the commission [the bribe] had nothing. According to the evidence, the fixed commission is 10 percent of the value of the licence, but was reduced in special cases to 5 percent." The typical commission in Nigeria was also 10 percent. In Senegal, when the state-run company to distribute fertilizer and seed was closed, "auditors discovered that most of the company's $250 million in bad debts were owed by about half a dozen politically well-connected businessmen" (*Wall Street Journal*, 29 July 1985, p. 18).

[14]The Commissions of Enquiry were the Akainyah (October 1963), Abrahams (April 1965), Ollennu (1966), and the Gaisie (September 1975).

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Defective Political Leadership

The prosperity or poverty of an LDC often depends on the existence of good or bad government; it is the political leadership that creates the environment within which development proceeds. This environment may be conducive to development by unleashing the creative and productive energies of the majority—the peasants—or it may be so repressive that it stifles local initiative and renders self-sustaining growth difficult to achieve. As Melvyn Krauss (1983, p. 3) remarked, "The fundamental issue facing the LDCs in the 1980s will be that of the proper 'policy environment' to further their economic development," an observation that is ruthlessly true for black Africa.

African political systems exhibit certain peculiarities that inhibit economic development: autocracy/kleptocracy, savage repression of the peasant majority, megalomania, and the religion of development. Of the 41 black African nations, only two (Botswana and Senegal) elect their leaders and permit public participation in government. Since 1957, there have been more than 100 heads of state in black Africa; only four of them (Abasanjo of Nigeria, Ahidjo of Cameroon, Nyerere of Tanzania, and Senghor of Senegal) stepped down voluntarily. (However, Senghor ruled for 20 years, Ahidjo for 22 years, and Nyerere for 24 years.) "The rest, a disgraceful lot, had to be removed by force or assassination, engendering political and economic instability" (Ayittey 1986a, p. 8). Those currently serving long terms (over 15 years) include Banda of Malawi, Houphouet-Boigny of Ivory Coast, Kaunda of Zambia, and President-for-Life Mobutu of Zaire.

African political regimes are characterized by their brutal repression of the peasant majority, the very group of people that produces the bulk of Africa's foodstuffs.[15] For example:

> In Togoland soldiers razed villages, killed livestock and beat peasants to clear them off land earmarked for the extension of a national park [*West Africa*, 5 October 1981, p. 2361].
>
> In 1981, when a group of peasant cocoa farmers in Ghana queued in front of banks to cash their government checks, policemen used canes on them for allegedly being "disorderly in the queue" [*Graphic*, 4 December 1982, p. 1].
>
> At Bantama, a peasant was beaten to death by soldiers for jumping a queue for soap. Then soldiers swooped on a number of people, including girls and women, some with babies on their backs and

[15]Black African leaders calling for sanctions against South Africa have themselves instituted more heinous de facto "apartheid" regimes in their own countries against their own people. For parallels between apartheid and tyranny in black Africa, see Ayittey (1985).

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> bundled them into trucks to be taken away to Tema Harbor to load cocoa [*West Africa*, 31 January 1983, p. 295].
>
> In September 1981, a 43-year old peasant woman, Kporkporvie Dada, was beaten to death by Ghanaian Border Guards for taking a gallon of kerosene to a relative in neighboring Togoland [*Graphic*, 23 September 1981, p. 3].
>
> Under the brutal regime of Idi Amin of Uganda, more than 300,000 peasants perished. His successor, Milton Obote, was no better; as many as 100,000 Ugandans were butchered [*Time*, 5 August 1985, p. 35].[16]

This is *not* the environment that black Africa inherited from the colonialists. As Bauer (1984, p. 90) puts it:

> The British colonial administrations governed firmly but lightly. They did not attempt to control closely the lives and activities of their subjects. Taxation was modest and people enjoyed virtually complete personal freedom, including freedom to choose their own activities, to move around unheeded and dispose their incomes as they wished.

The socialist ideology adopted by many African leaders initially served as a symbol of rebellion against the capitalistic colonial economic system, but it quickly became a convenient device for African leaders to perpetuate their own rules. It was the wrong ideology in the wrong place. The ideology is alien to black African traditions. African peasants are socialistic or communalistic, but they do not participate in their traditional economic activities (farming, fishing, etc.) because their chief orders them to and reaps all the profits. Nor does the chief impose price controls and other economic restrictions. Free markets and free trade have always been part of black African traditions.

The post-colonial socialism practiced in Africa allowed the head of state and his phalanx of kleptocrats to rape and plunder the wealth of the peasants. While preaching socialism, Nkrumah himself was stashing millions of dollars abroad.[17] Nobody came closer to the African definition of socialism than Krobo Edusei, an ex-Minister in the Nkrumah government: "Socialism doesn't mean if you have made a lot of money you can't keep it" (quoted in Fitch and Oppenheimer 1966).

[16]Had that many African giraffes or zebras been slaughtered, experts or the world would have moved with lightning swiftness to place them on an endangered species list and instituted all sorts of protective measures for them. But never mind the Bazonga tribesmen living next to the giraffes.

[17]Nye (1967, p. 417) put the figure at $30 million; a Ghana Government Commission (*Apaloo Report* 1967) placed it at £2,322,009.

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The popular notion that the LDCs are innocent victims of avaricious colonialists and imperialist exploiters is often patently false. The four richest persons in the world are Third World leaders: the Sultan of Brunei ($30 billion); President Mobutu of Zaire ($5 billion); Ferdinand and Imelda Marcos ($5 to $10 billion); Mrs. Suharto of Indonesia ($3 billion), not to mention the late Shah of Iran, Arab sheiks, and Duvalier (Ayittey 1986d).

For orthodox development economics to assume that such wanton looting of the wealth of the Third World by its leaders has no bearing on the pace of development is out of touch with reality. President Mobutu's $5 billion fortune could pay off his country's entire foreign debt of $4.4 billion and then some (*West Africa*, 30 November 1981, p. 2881). Lest one regard these peculiarities as indigenously African, Bauer (1984, p. 104) reminds us that "despotism and kleptocracy do not inhere in the nature of African cultures or in the African character; but they are now rife in what was once called British colonial Africa, notably West Africa."

The elites failed and betrayed Africa. They instituted controls to cater to their needs only. When an African government says "Food for the masses at cheaper prices," more often it means "for the elites." As Robinson (1971, p. 43) contended:

> The ruling elites use their governing authority to extract wealth from the productive classes and spend it on prestigious status symbols, luxurious living as an imitation of the standards of the richer metropolitan countries. Certainly the grand public buildings, airlines, Rolls Royces [Mercedes Benzes], political patronage and corruption all present formidable obstacles to internal capital formation and productive investment. These barriers are not likely to be removed by supplying missing economic factors of capital, education and entrepreneurship from outside. What incentive does the peasant farmer have to produce more when through taxation the surplus is siphoned off to be spent in conspicuous consumption?

There is a peculiar tendency on the part of black African leaders to select development projects that emphasize grandeur rather than economy. In Ghana, there was a consistent tendency for the government to opt for "modern" capital-intensive techniques and projects. Uphoff (1970, p. 562) cites a pharmaceutical factory, where a relatively modest design was turned down in favor of another which eventually cost nearly ten times as much and which included "eleven bungalows for managers, a handsomely fitted administration block, a large cafeteria with one of the biggest and most modern kitchens in Ghana, and housing for experimental animals better than those in which most Ghanaians lived." Other examples abound:

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> Hundreds of millions of dollars went to build five-star hotels and international airports in the remote jungle villages of Ivory Coast President Felix Houphouet-Boigny and Zairian President Mobutu Sese Seko. . . . Shortly after independence, Madagascar bought a jet plane and proudly named it The Revolution. Now, Chase Manhattan is trying to repossess The Revolution [*Wall Street Journal*, 15 July 1985, p. 18].
>
> Nigeria's Shagari for instance began the construction of a new capital about 30 miles northeast of Lagos, at an estimated cost of $16 billion. Yet hundreds of thousands of Nigerians in the slums of Lagos lacked running water, medical care and educational facilities. President El Hadj Omar Bongo of Gabon, an oil-producing country with a foreign debt of $1 billion, built a $27 million conference center with a facade of imported Italian marble for the 1977 summit meeting of the Organization of African Unity in the capital of Libreville [*Time*, 16 January 1984, p. 28].

Perhaps the most serious failing of African leadership is its abiding faith in the religion of development. Ghana's Nkrumah was perhaps its most ardent believer and apostle. In exile after 1966 and responding to charges of economic mismanagement, he asked:

> How can the obvious evidence of modernization and industrialization of Ghana, such as new roads, factories, schools and hospitals, the harbor and town of Tema, the Volta and Tefle bridges and Volta Dam be reconciled with the charge of wasted expenditure? . . . You only have to look around you to see what we achieved. We built more roads, bridges and other forms of national communication than any other independent African state. We built more schools, clinics and hospitals. We provided more clean piped water. We trained more teachers, doctors and nurses. We established more industries [Nkrumah 1973, pp. 394–417].

Tragically, only quantity mattered. This religion drove African leaders to place extraordinary emphasis on "modern" paraphernalia and to disregard commonsense alternatives. For example, the government of Ghana directed that sugar be grown under irrigation even though peasant farmers were low-cost producers (Killick 1978, p. 229).

Between 1960 and 1965, the number of tractors increased 25-fold, despite foreign exchange shortages and plentiful supplies of land and labor (Killick 1978). As I have argued elsewhere (Ayittey 1986b):

> Illiterate peasant farmers simply cannot bridge the huge technological gap between their simple hoes and a modern tractor. A horse-drawn cart, for example, would make better sense and be of much more help to African peasant farmers. From their farms they carry out their produce on their heads! Since there is a physical limit to what can be carried on the head, whatever produce that couldn't

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> was left to rot on the farms. In 1981 and 1982, there were several reports of food rotting on the farms at a time when there were rife shortages of food in the cities.
>
> A simple horse-drawn cart can increase the amount of food reaching the markets by more than tenfold. Furthermore, a horse-drawn cart does not need macademized roads. Nor does it need foreign exchange for oil, gasoline and spare parts. We have plenty of timber in large parts of tropical Africa and horses too.
>
> But the elites of Africa couldn't be interested in such simple ideas. After all, U.S. farmers don't use such primitive conveyances. As for the horses, we race them in Africa. The white colonialists did it; so too must we.

Little has changed since Dumont (1966, p. 58) raised the issue over 20 years ago: "The problem of mechanization is crucial because African elites are seduced by the idea of modern machines. It is difficult to convince them that agricultural progress does not depend on immediate and complete mechanization."

An Indigenous Agricultural Model

According to a 1981 United Nations Food and Agriculture Organization (FAO) report (p. 3):

> Africa can feed itself. Even without using modern farming techniques such as pesticides and with only the most casual approach to maintaining the soil, the 51 countries of Africa presently have the potential to feed a population three times as large as that now living on the continent, even allowing for the fact that 47 percent of the land surface is useless for crops.

Many agricultural projects and programs have failed in Africa because they did not fit into Africa's traditional environment. To be successful, an agricultural project must recognize that the bulk of Africa's foodstuffs is produced by illiterate peasant farmers who are mostly women; land is communally owned and the custodians are the chiefs whose authority, respect, and stature far exceeds those of African governments; and the indigenous economic system is characterized by free trade, free markets, and profit-sharing schemes such as *abusa* and *abunu*. For example, an African government could hand over all of its state farms to the chiefs to be operated on an *abusa,* or share-cropping basis.[18] The net proceeds from the chief's farm could be

[18]Even the report of the Okoh Commission (1974, p. 130) recommended that the government should stay out of direct production of food. The Commission suggested that the Ministry of Agriculture should operate "by achieving through others (i.e. private farmers and breeders) the greater part of Ghana's agriculture and livestock production, rather than by its own activities as a direct food producer."

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divided into three: a third to the government (either as taxes or recoupment of expenses), a third to the workers, and a third to a development fund or "traditional pot." The funds from the "pot" could be used for development projects on a 50/50 cost-sharing basis with the government.

Such a scheme has many advantages. It places those in charge who better understand local conditions. It also has a built-in incentive scheme. Chiefs would have to produce more to get a bridge or a hospital; in effect, they would barter the prospects of a hospital for more food. The scheme holds the promise of drastically cutting development budgets, which have been the underlying causes of deficits in Africa. Finally, the scheme would channel the traditional rivalries between African tribes into productive work. Tribal superiority or pride would be determined by the quality of a tribe's schools, hospitals, or bridges, not by the numerical strength in spears and arrows or tribesmen.

Foreign governments and international aid agencies can help by channeling assistance through local chiefs or traditional leaders rather than through corrupt central governments. Emphasis should be placed on rejuvenating or improving traditional cottage industries. For example, native fishermen use primitive dugout canoes that are produced by indigenous industries. More canoes could be produced or widened so that more fish could be landed.

But foreign governments and aid agencies are not likely to know about such traditional cottage industries; they are more inclined to export to Africa technologies they are familiar with. Unfortunately, such technologies may not fit into Africa's traditional environment and consequently may fail. In addition, African leaders themselves are not interested in the country's indigenous cottage industries. For example, Ghana set up a State Boatyard Corporation in 1972 to build pleasure aluminum boats; in nine years, the Corporation launched only six vessels (*Graphic*, 14 August 1981).

Conclusion

There were two basic reasons why black Africa failed to develop after independence in the 1960s. First, its leadership was given to megalomanic, kleptocratic tendencies and was obsessed with imitating the West (the religion of development). The solutions to Africa's development problems are already in Africa, but African leaders cannot see them because they are too busy aping foreign modes of production and consumption. Second, the prescriptions of the orthodox development theory were woefully removed from reality; they

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failed to address systematically the environment within which black African development occurs. The reality was recently sketched by a Ghanaian peasant, Amoafo Yaw (*Graphics*, 17 February 1982, p. 3):

> In this country, much noise is being made about the exploitation of the people. . . . But as far as I am concerned, it is the STATE, as the Chief Vanguard, and her so-called Public Servants, Civil Servants which actually exploit others in the country. . . .
>
> The money used in buying the cars for Government officials, the cement for building estates and other Government bungalows which workers obtain loans to buy, the rice workers eat in their staff canteens, the soap, toothpaste, textiles cloth which workers buy under the present distribution system all come from the farmers' cocoa and coffee money. . . .
>
> This STATE-MONOPOLY CAPITALISM has been going on since the days of the colonial masters and even our own Governments after independence have continued the system. . . .
>
> The farmers realising this naked exploitation decided unconsciously that they would no longer increase cocoa and coffee production, they would not increase food production and any other items which the State depends on for foreign exchange. In effect, there will be no surplus for the state to exploit.

In conclusion, until black Africa can depoliticize its development strategy and return to a realistic view of its near-term growth possibilities, the economic atrophy experienced in the post-colonial period will continue. A combination of indigenous methods of production and enhancement of market activities offers black Africa an alternative and viable route to economic growth. The natural wealth of the countries that comprise black Africa remains untaped; it is now up to the African people and the world development organizations to face reality and discard the autocratic mode of government and the state capitalism that have characterized the black African development process.

The evidence in this paper and the work of Peter Bauer disprove the conventional wisdom concerning the socialist path toward economic progress in black Africa. Instead, the future rests with the African people adjusting to their own traditions while adopting those modern practices that increase the efficiency of market exchange—especially a stable government by law. And with political stability, economic stability and progress will follow.

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The Internal Forces Afflicting Africa

Peter Kilby

Africa is suffering. In the past two dozen years the subcontinent has been smitten by two catastrophic droughts, civil war in countries that encompass more than half of all its inhabitants, disruptive international violence in the northern and southern regions, and an adverse shift in its external terms of trade. But as Professor Ayittey (1987) so vividly portrays, the material well-being of Africans has been diminished by the operation of yet additional, internal forces. Faulty economic policies and a lack of honesty among its leaders have turned up the purgatorial fires endured by its hapless citizenry.

The prominence given in Ayittey's paper to fiduciary looting as a macroeconomic variable is an insight of recent origin. On the other hand, suppressed national output in African economies as an inevitable consequence of comprehensive economic controls is a theme proclaimed by Peter Bauer more than 30 years ago. Before proceeding to Ayittey's political and cultural analysis it will be helpful to take a closer look at the economic record and the natural sequence in which the policies he excoriates evolved.

The Economic Record

The basic indices of Africa's economic performance since 1960 are seen in Table 1. Growth in GDP has been about half that of all developing countries; when population expansion is brought in, growth has been zero or negative since 1973. Around this average, of course, there is considerable variance. For the entire period 1960–82, five of the subcontinent's 45 countries (including Ghana) have suffered annual declines in per capita incomes in excess of 1 percent; in contrast, all four oil exporters and seven other countries have exceeded 2.5 percent.

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TABLE 1

MACROECONOMIC INDICES FOR SUB-SAHARAN AFRICA
1960–84
(ANNUAL AVERAGE PERCENTAGE CHANGE)

	1965–1973	1973–1980	1980–1984	Per Capita 1973–80	Per Capita 1980–84
African GDP	3.9	2.7	1.1	0.0	−2.1
GDP, all LDCs	6.6	5.5	2.9	3.3	0.7

	1960–70	1970–80	1980–82
Total Agriculture	2.7	1.3	—
Food Production	2.6	1.6	0.7
Per Capita Food Production	0.1	−1.1	−2.5
Terms of Trade[a]	2.0	−0.4	−4.7
Export Volume	5.5	−0.6	−9.7
Import Volume	5.0	7.4	−5.4
Investment-GDP Ratio	15.6	21.6	21.5

[a]Exclusive of oil exporters. The percentage change in the oil exporters' net barter terms of trade for the three periods was 1.2, 17.4 and 1.8 percent.
SOURCES: World Bank (1984, pp. 16–17; 1985, pp. 149–53).

The move from a poor performance in the 1960s to a dismal performance since 1970 was in part exogenous shock, as noted in the opening paragraph, and in part human design. The human design was a rising investment-GDP ratio, driven by rising public "investment" of the type Ayittey details so well; a comprehensive set of governmentally created price distortions is perhaps an even more important part of this design. Arising from quantitative import restrictions, artificial exchange rates, statutory producer prices, and disequilibrium wage rates in the public sector, these price distortions have shriveled incentives for food production and agricultural exports while creating windfall gains for urban consumers and monopoly profits for shallow, high-cost import-substitute industries.

Thus it has not been the decline of a few percentage points in the external terms of trade, shown in Table 1, that has led to constricting exports. Rather export production has fallen because the government has pushed down the price to the farmer, through a combination of confiscatory producer prices and an overvalued exchange rate, so as to leave him with only 20 to 40 percent of the f.o.b. export price when valued at an equilibrium exchange rate. And the farmer's income is further reduced as the price of local manufactures he purchases sell

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from 40 to 80 percent above their previous cost when imported. The results of all this has been a perverse redistribution of income and a devastated commercial agriculture.

A Non Sequitur

As Ayittey indicates, the justification for "squeezing agriculture" was to promote industrialization. In most countries the farm sector has been crippled with no offsetting advance in industrialization. The Stalinist model has provided pain, but no gain. It is ironic that this is an instance where no hard political choice had to be made: an advancing agriculture entrains high rates of manufacturing growth. The evidence that this has been so in Africa is presented in Table 2.

Are not farming and industry competing for the same scarce resources? What complementary forces did policymakers overlook? First, and most obviously, there is the demand side: farm household income is the largest single component of purchasing power devoted to manufactures; as it expands so too does the market for manufactures. On the supply side, agricultural growth or the lack thereof is a major determinant of manufacturing costs through its impact upon: (1) the food component in the wage bill, (2) the price of agricultural raw materials used in industry, and (3) the exchange rate via the relative abundance of farm exports, thereby influencing the cost and availability of all imported industrial inputs. Indirectly, the type of

TABLE 2

A CHOICE BETWEEN AGRICULTURE OR INDUSTRIALIZATION?

	Annual Growth in Output 1970–80(%)	
	Agriculture	Manufacturing
Mozambique	−1.8	−5.8
Ghana	−1.2	−2.9
Uganda	−0.9	−9.1
Zimbabwe	−0.5	2.8
Chad	−0.3	−0.8
Ethiopia	0.7	2.4
Upper Volta	1.2	3.7
Sierra Leone	2.2	3.8
Ivory Coast	3.4	7.2
Cameroon	3.8	5.2
Malawi	4.1	6.7
Liberia	4.7	10.6
Kenya	5.4	11.4

SOURCE: World Bank (1982, p. 114).

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policies associated with expanding agriculture are the same as those associated with a competitive industrial sector. As Table 2 suggests, these contributions, which take place autonomously if the market mechanism is not repressed, outweigh the resource transfer obtained from "squeezing." In agrarian economies industrial growth does not occur at the expense of agricultural growth, but because of it.

The Spread of Controls

The interventions to tax agriculture have required further interventions. Ensuing scarcities and cost-of-living considerations drew governments into the business of provisioning worthy groups at "reasonable," below-market prices. Thus they entered the quagmire of licensing and price controls in order to direct subsidized food to irate urban consumers, subsidized fertilizer to a lagging agriculture, and subsidized raw materials to stumbling manufacturing industries. But more often than not policymakers found that civil servants, licensed distributors, and some final consumers subverted their policy by encashing the implicit rent in the parallel market, reselling the licensed commodity to the highest bidder.

Frequently policymakers have responded to this embezzlement of subsidy by establishing public corporations to deliver directly to the target group. As Douglas Rimmer (1984, pp. 197–98) pointed out:

> Where imports are licensed, public corporations have been set up to participate in, or even monopolize, the import trade. Where imports of staple foodstuffs are subsidized, another corporation can be made responsible for their distribution. Where agriculture inputs are made cheaply available to farmers, their supply can be entrusted to a ministry of agriculture. Where the rentals of urban housing are to be held down, a government housing corporation can be made responsible for new construction.

Unhappily this response to the first mistake is to step yet deeper into the quagmire, substituting staggering administrative cost and impaired delivery for diversion and embezzlement. An undesired redistribution of national income is replaced by a reduction in national income.

By the early 1980s, noted Rimmer (1984, p. 262), virtually every African head of state had denounced parastatal bodies as inefficient, wasteful, corrupt, and irresponsible. However, the inference is never drawn that state enterprises are an inappropriate instrumentality. Rather they are abjured to be less inefficient, less wasteful, less corrupt, and less irresponsible in the future. Similarly the policy-contrived transformation of the structure of the economy is conceded to have been a failure. The explanation has not been that the strategy

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is misconceived, but that it is insufficiently comprehensive. State enterprise in manufacturing can be extended into large-scale farming to obtain self-sufficiency in foodstuffs. The mistake is to be rectified by enlarging its scope.

Why Do the Misguided Policies Persist?

Why have so many African countries pursued these punitive economic policies for so long? There has been no perceptive change in the pattern since the mid–1950s when internal self-government was first obtained. If the doomsday machine is to be shut down, the causes for this seemingly suicidal behavior must be isolated.

Peter Bauer (1984, p. 105) has argued that it is the outcome of the last phase of colonialism, the dirigiste, and welfare-oriented policies that "contributed greatly to the creation of a new political climate in which despotism was likely to emerge and corruption bound to flourish." Clearly, Ayittey's triad of megalomania, kleptomania, and imitation is four-square in the Bauer tradition. Robert Bates (1981) sees a political rationality in the persistent pattern: for very insecure governments heavy taxation of farm output with a redirection of the proceeds to subsidize rural social services on a geographically selective basis is a most efficient instrumentality to repay political debts, undermine political opposition, and to generally maintain political control.

If this analysis is complete, the prospects for Africa are not very hopeful. To shift to decentralized free markets as the principal agency of economic management, beyond its potentially traumatic implications for incumbent rulers, effects a triple amputation on the winning actors in the system. It cuts off the means to take visible, responsible interventions as called for in the traditional morality. It cuts off the possibility to amass a personal fortune. And it cuts off that most intoxicating commodity known to man, direct power over his fellow men. We have seen little evidence that any of the political actors in Africa are willing to accept such delimitations.

But one must wonder if something is not missing. Surely, with the sample of over 100 like-minded African rulers since 1960, Ayittey's implicit assumption of kakistocracy can not hold. Since so many men have persisted so long, and since we have no warrant to assume that Africans learn less from experience than other men, we can only conclude that these actions possess an ex ante noneconomic utility that make them worth their cost.

All Africans that the writer has encountered over the past decade—layman and economist, farmer and urban dweller—condemn the

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rascals in power and the effects of their policies; but none have suggested that controls should be abandoned. Rather they urge that these controls be put right. The press, other organs of opinion, the academic community—nowhere is the advice heard to explore a free market regime. The writer participated in an experiment in which 50 ranking African economists and Permanent Secretaries from 22 countries were sequestered in an Oxford college for five days and subjected to grueling intellectual self-examination administered by one of the world's largest aid agencies, all of which was aimed at conversion to a less interventionist approach to economic management. After five days there was not a single convert. Within this context, Ayittey is a John the Baptist crying in the desert.

In sum, we are not dealing with a system that has persisted because it shields the incumbent party from political competition or because it enriches those individuals who man the controls. On the contrary, it is a system that is so right in the eyes of the citizenry that it continues to be embraced despite outrageous abuse and extraordinary inefficiency.

Conclusion

Interventionism in Africa is, at least in part, the pursuit of a moral goal, an attempt to move closer to the egalitarianism of precontact traditional African society. In these intimate small-scale societies accumulation of productive wealth was not encouraged; on the contrary, the accumulation of private wealth, with its potential for control over the activities of others, was restricted by a wide variety of social arrangements—increased ceremonial offerings, marriage of additional wives, financing of marriage for relatives, obligations to kin, gift giving. The aim was always to prevent the emergence of permanent economic inequality (Charle 1970). Intervention by the chief, the duly constituted political authority as described by Ayittey, to maintain an equitable society has deep roots.

If this analysis captures an element of what is going on, is there anything useful that can be abstracted from it? Perhaps two things. First, understanding and patience. Although it will take longer in Africa, Nehru's India is a clear parallel. Second, equity—not efficiency—should be the centerpiece in the campaign to win over public opinion to market liberalization. Owing to the long accumulation of price distortions, open competition in unfettered markets will lead to an improvement in the distribution of income. In the near term pursuit of Africa's moral objectives is also the pursuit of economic efficiency.

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THIRD WORLD DEBT: LEGACY OF DEVELOPMENT EXPERTS

Paul Craig Roberts

> In the future, we should try to move toward a common recognition of aid to underdeveloped countries as a collective responsibility for the developed countries, the burden of which should be shared in an agreed fair way, amounting to *an approach to a system of international taxation.*
>
> —Gunnar Myrdal[1]

Debt and Development: The Crowding-Out Effect

Four decades ago, in the wave of the internationalism ushered in by two world wars and coincident with the beginning of large-scale decolonization, the West found itself confronted with a new entity that was to become known as the Third World. The terms "underdeveloped countries" and "less developed countries" were coined to take account of these nations and our perspective of them, and the field, development economics, was crystallized to address the problems that these new nations faced.

Today, many of these nations are still underdeveloped by Western standards. In addition, some nations that once seemed on the way up now find themselves statistically grouped with nations that are many generations their juniors. It would be almost farcical to refer to many of these nations as "developing" in the optimistic lexicon of the past. Instead, they are now more commonly known as the "debtor countries."

This revision in taxonomy is not mere whimsy or rhetoric. Latin American debt is now approaching $400 billion. Sub-Saharan Africa

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[1]Myrdal (1970, p. 365).

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has foreign debts exceeding $50 billion. The focus of attention has shifted to the inability of Third World countries to make good on their debts—debts that are said to be crippling their respective economies.

The debt problem elbowed its way to attention in 1982, when Mexico announced that it could not pay its debts. The problem was seen as a political one. The multilateral lending agencies and Western governments stepped between the original principals in the loans, private banks on one side and Third World governments on the other. This culminated in a process of lending money to pay interest while pushing for economic policies to facilitate debt servicing in debtor nations that generate large trade surpluses. Somewhere along the way economic development was crowded out by debt.

The Rule of Experts

The crowding-out process began when Third World development was placed in the hands of Western academics, Third World governments, and international bureaucrats. From the beginning, "development planning," as it was called, substituted foreign loans for foreign and domestic equity in order that the investment process could be controlled by the government's development plan. Consequently, economic life in developing countries was politicized from the start, with markets taking a back seat to governments. Peter T. Bauer, whose skepticism of the wisdom and benevolence of government rivaled development economists' skepticism of markets and private investment, doubted that development planning would succeed. He was wont to remind his colleagues (Bauer 1972, p. 73):

> The state cannot create new additional productive resources. The politicians and civil servants who direct its policy dispose only of resources diverted from the rest of the economy. It is certainly not clear why overriding the decisions of private persons should increase the flow of income, since the resources used by the planners must have been diverted from other productive public or private uses.

Others, however, were confident that only planning would bring development. Gunnar Myrdal (1965, p. v), an eventual Nobel laureate, described the extent of the faith in planning in the 1960s: "In the under-developed countries outside the Soviet Union, national economic planning is almost everywhere a commonly acclaimed ideal." Earlier Myrdal (1956b, p. 201) wrote, "All special advisers to underdeveloped countries who have taken the time and trouble to acquaint themselves with the problems, no matter who they are . . . all recommend central planning as a first condition of progress."

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Myrdal (1956a, p. 65) did not decry this mistake. He wrote, approvingly:

> But *the alternative to making the heroic attempt is continued acquiescence in economic and cultural stagnation or regression which is politically impossible in the world of today;* and this is, of course, the explanation why grand scale national planning is at present the goal in underdeveloped countries all over the globe and why this policy line is unanimously endorsed by governments and experts in the advanced countries.

Not all development economists were ideological advocates of planning. A committee of leading development experts, in a volume sponsored by MIT's Center for International Studies, simply believed that "there are limits to the effectiveness of the private market institutions, especially where development must be accelerated. It may be necessary to plan out in advance the key pieces of a general development program (Millikan and Blackmer 1961, p. 64)." Columbia University professor Ragnar Nurkse (1953, p. 84) believed that "private foreign enterprise in the past has not done much to spread industrial development to the backward agricultural countries, but has concentrated rather on primary production for export to the advanced countries."

Other economists were more strident in their beliefs. Stanford professor Paul Baran (1962, pp. xxviii) wrote: "If what is sought is *rapid* economic development, comprehensive economic planning is indispensable." He then explained (p. xxix): "No planning worth the name is possible in a society in which the means of production remain under the control of private interests which administer them with a view to their owners' maximum profits (or security or other private advantage)." Baran (1962, pp. xl–xli) cast aside the history of economic development with a wave of the hand:

> To conclude: the dominant fact of our time is that the institution of private property in the means of production—once a powerful engine of progress—has now come into irreconcilable contradiction with the economic and social advancement of the people in the underdeveloped countries and with the growth, development, and liberation of peoples in advanced countries. That the existence and nature of this conflict have not yet everywhere been recognized and fully understood by the majority of people is one of the most important, if not the decisive, aspect of this conflict itself. It reflects the powerful hold on the minds of men exercised by a set of creeds, superstitions, and fetishes stemming from the very institution of private property in the means of production which now desperately needs to be overthrown.

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The above passage, from a widely used textbook by an internationally renowned development expert, exemplifies the basic problem of the development field. Development economics asserted that private property was incompatible with progress. By telling this to the Third World, we exposed a lack of belief in our own institutions and undermined the role of private equity in the development process.

Bauer's Reply to the Planners

Peter Bauer disputed the notions used to justify central planning. In an argument similar to Nurkse's, Baran (1962, p. 177) claimed: "The economic surplus appropriated in lavish amounts by monopolistic concerns in backward countries is not employed for productive purposes. It is neither plowed back into their own enterprise, nor does it serve to develop others." Bauer's (1984, p. 22) response was straightforward: "This statement is patently untrue. In the less developed world large industries such as the oil, copper, tin, rubber and coffee industries, to mention but a few, have been financed through reinvested profits."

Likewise, the general argument that the manufacturing industry was the key to a developing economy, and thus requires a government plan to ensure its even development, was disputed by Bauer (1972, p. 142): "This argument is again irrelevant: the development of manufacturing industry does not depend on comprehensive central planning; and development does not depend on the enlargement of the manufacturing sector."

The endowment of governments with extensive control over their economies set up conditions exactly opposite to those required for economic growth. Individual initiative and independence gave way to manipulation of government connections. Bauer (1984, p. 27) wrote:

> In closely controlled economies, the decisions of politicians and civil servants take the place of private decisions in production and consumption. Economic life is extensively politicized. Official directives replace voluntary transactions. The decisions of the rulers largely determine people's incomes and employment opportunities. Indeed, these decisions often determine the economic or even the physical survival of large sections of the population. In such conditions, who has the government becomes all-important for large numbers of people.

Western insistence on development planning helped to saddle poorer nations with easily corruptible economic and political systems. Today Professor George Ayittey (1986) damns the "kleptocrats (armed government looters) and incompetent bureaucrats" who have squan-

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dered and stolen billions of dollars of development resources from the people who could least afford to lose them.

Economic planning in the Third World came to mean much more than government bureaus channeling loans, approving licenses, and applying tariffs and subsidies. Planning entailed state ownership of industries, including the nationalization of enterprises owned by foreign companies. Third World nations have been little concerned with the effect of outright confiscation on the flow of private investment, because, as Myrdal (1965, p. 183) noted, "There is a widespread feeling that the direct attraction of private investment from abroad is too costly a way of inducing capital inflow."

Disregard for Property Rights

The disrespect for private property in the Third World not only impaired the ability of underdeveloped nations to attract private investment from abroad; it led also to a loss of massive amounts of capital from domestic sources. A sampling of 18 Third World countries by Morgan Guaranty Trust Company (1986, p. 13) revealed that these nations suffered $198 billion in capital flight from 1976 to 1985. Mexico alone lost $53 billion.

It is remarkable that in our own hemisphere, despite the example of American capitalism, the state dominates so many economies. After "the largest privatization campaign" in Brazilian history, there are still over 340 state-owned companies in Brazil. It has been estimated that "in 1980, 70 percent of all capital investments went to state-owned companies" in Brazil (*Infobrazil* 1985).

In Argentina an estimated 60 percent of the economy is state owned, with the rest subject to all forms of government regulation. A member of the Argentine Chamber of Deputies related an especially poignant example of government inefficiency: the annual interest on the debt of the Argentine coal mines amounting to more than $80 million, compared with annual sales of less than $30 million (Alsogaray 1984).

Mexico, which expropriated its private banks in 1982, is now selling back 34 percent of the banks' shares. This meets privatization demands of creditors without freeing the banking system. To secure its latest debt bailout package, Mexico also promised to "modernize, merge or close about 300 of its 500 state-owned corporations" (Pine 1986). Some nations find it harder to deprogram themselves of the fear of private enterprise drummed into their heads by so-called development experts. One would think that Peru, unwilling or unable to service its debts, would be encouraging private investment. This was hardly the message sent out by Peruvian President Garcia in

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August 1985, when the foreign oil company, Beloc, was confiscated by the government, with no compensation paid for its book assets of $400 million (Graham 1986).

Bias Against Private Investment

Third World distrust of foreign private enterprise, called by the MIT committee "a convenient symbol of the external domination from which such a society seeks to liberate itself," led in many countries to an outright blockage of direct private investment (Millikan and Blackmer 1961, p. 65). This sort of policy was urged by Baran (1962, p. 184), who wrote:

> It is very hard to say what has been the greater evil as far as the economic development of underdeveloped countries is concerned: the removal of their economic surplus by foreign capital or its reinvestment by foreign enterprise.

Baran (1962, p. 184) complained of "the pronounced paucity of the direct benefits derived by the underdeveloped countries from foreign investment." Countries wishing to finance the planned development prescribed by experts were advised not to depend on private investment (domestic or foreign); instead, they borrowed and relied on foreign loans to finance their pet projects. As Nurkse (1953, p. 89) advised, "Foreign loans for capital expenditure by public authorities have the advantage that they can be used for domestic economic development in accordance with a coherent over-all programme." This program, of course, devised and implemented by government bureaucrats, was by definition the best use of resources, and it would easily pay back the debts incurred, or so it was thought.

Some Western observers realized the danger of leaving to chance the ability of underdeveloped nations' governments to borrow the necessary resources. They proposed stepped-up lending by Western governments. In his famous report to President Truman, Gordon Gray (1950, p. 13) asserted, "Under present conditions a heavy reliance on public lending must be recognized as essential for an aggressive development program." Gray (1950, p. 63) explained:

> The probable inadequacy of the total volume of private foreign investment available for most areas is not the only reason for this conclusion. Economic development requires funds for the construction of facilities which are ordinarily not attractive to private capital and therefore in most cases must be financed by public funds.

The argument for loans tied to projects was undermined to a degree by Nurkse (1953, p. 96), who argued, "The desire of the lending or giving country to tie its aid to specific investments is understandable,

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but this procedure by itself cannot assure the desired effect. There is no substitute for comprehensive planning and budgeting of natural resources." In this reasoning, the projects themselves took a back seat to the existence of a central investment plan, which determined the priority of investments.

In other words, development experts were claiming either that private investment was evil and should not be allowed, that private investment was inadequate and public aid was necessary for certain projects, or that public aid was necessary regardless of the projects. No matter what line was taken, private property took a bashing.

Debts Gone Sour

Bauer was suspicious of public aid and insisted on introducing alien concepts into the discussion: such notions as "productive," "market demand," and "motivations." Noticeably absent from the development plans was the idea that what the people of the underdeveloped country wanted actually mattered. Moreover, there was an almost supernatural belief that government investments would generate the wealth to pay back the debts incurred despite these investments not being guided by any market sense of profitability or productivity. The fact that private investment does not flow into these uses on its own implies that the projects would not generate the wealth necessary to service the loans that finance the projects. Separating the projects from the only objective measure of their worth resulted in declining economic performance and rising political instability. It is no accident that the reliance on planning and borrowing has culminated in the debt crisis. These twin beliefs of the development creed placed resources in unaccountable government hands.

The matter was compounded when Western banks, forgetting the laws of capitalism to which they owe their existence, made large loans to socialist Third World governments. By discounting the likelihood that enough wealth would be generated to pay back the loans, banks removed the last market condition from the process, virtually ensuring that the loans, and the entire development process, would sour.

By following the development creed, Third World leaders found themselves with vast amounts of resources at their fingertips for use at their discretion. As we should know by now, entrance into government does not magically transform human nature. It cannot be surprising that Third World leaders are among the richest people in the world.

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The approach taken to the debt crisis has worsened economic and political conditions in debtor countries. The loans that have been used to prevent technical default have increased the debtors' indebtedness. Total debt has risen 25 percent over the past four years, from $809 billion to $1.01 trillion. Long-term debt has grown by more than 37 percent from 1982 to 1986 (World Bank 1986, p. xi). These statistics can hardly be viewed favorably, and the growth of debt hardly constitutes a solution to the debt problem.

Western policymakers still have not shaken off the reliance on debt. Treasury Secretary James Baker's plan, laudable in its attempt to force privatization in the debtor countries, offers the carrot of more loans. The Mexican bailout of July 1986 is primarily a mechanism to furnish Mexico with $12 billion in new loans. The World Bank seeks to "nearly double its loan authority for Third World aid by 1990," increasing its loan level to $21.5 billion (Rowen 1986). Proposals to reduce the debt have been attacked because development is still believed to depend on loans. Unfortunately, more loans are probably the last thing these nations need.

The Failure of Austerity Programs

The other cornerstone of the debt "solution" has been the adoption of austerity programs in debtor countries under the advisement and monitoring of the International Monetary Fund (IMF). Typically, these programs entail cutting government spending and raising taxes to balance the budget; slowing monetary growth and freezing wages and prices to slow inflation; and devaluing the currency and raising taxes further to cut domestic demand. This mishmash of policies is designed to facilitate debt payment in the short run, but it hurts it in the long run by damaging the economy and adding to political instability. The combination of wage freezes, tax increases, and import restrictions destroys the incentives of workers and drives the most enterprising citizens into the underground economy or out of the country.

The wrenching austerity plans are not out of character with the original thinking of some development planners. Myrdal (1957, p. 84), for example, wrote, "There is no other road to economic development than a forceful rise in the share of the national income which is withheld from consumption and devoted to investment. This implies a policy of the utmost austerity."

Today the populace of many Third World nations finds itself in the position of enforced poverty in order to pay for the mistakes of development planners. The per capita gross domestic product of debtor

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countries that have accepted austerity in exchange for a rescheduling of their debts is now on average about 10 percent below the precrisis level. For many countries, such as Peru, Venezuela, and the Philippines, the decline has been about 20 percent, with Mexico, Chile, and Uruguay experiencing even larger declines. It is a dangerously destabilizing situation that breeds resentment toward the West. Even relatively responsible politicians often have no recourse but to point their finger at the West. In Argentina, the workers occupied the factories when President Alfonsin first agreed to an IMF austerity plan. Strikes and protests in Panama forced the government to repeal its austerity plan. Violent riots greeted the announcement of plans in Jamaica and Dominican Republic. The most dramatic addition to the unemployment rolls due to IMF austerity was Sudan's former leader, Nimeri, who was deposed in a 1985 coup while in Washington conferring with the IMF.

Institutionalized Barriers to Development

Bauer (1972, p. 78) has stressed the attitudinal basis of economic development. "What is not in doubt," he wrote, "is the presence in many underdeveloped countries of long-standing and interrelated attitudes, beliefs and cultural traditions uncongenial to material advance, and often also a comparative weakness of personal capacities which favour it." Foremost among these unfavorable attributes he listed: "lack of initiative, self-reliance and a sense of personal responsibility for the economic fortune of oneself and one's family." It is a cruel irony that development planning institutionalized these barriers to economic development in the social systems of Third World countries.

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The Mischief of Moving Average Pricing

Alan Walters

Averaging in Marginal Cost Pricing

One of the strangest paradoxes is the ubiquity of instructions to fix prices at long-run marginal cost in spite of the clear implication from the theory of welfare economics that one should price at short-run marginal cost. The temptation, apparently common to all bureaucracies, seems to be to use some sort of long-run marginal cost so as to avoid the oscillations (that is, the reality) of short-run marginal costs. In practical terms this implies some averaging or spreading of the fixed costs over the projected outputs to produce some mutant of average costs, and calling it long-run marginal cost. Fixing price according to this bastard concept is theoretically absurd and, in practice, has lead to considerable waste.[1]

There is, however, some vestigial rationalization for such antics. After all, it is difficult to measure short-run marginal costs, and in most industries the short-run marginal cost does tend to move in greater amplitude than average costs. The task of tracking short-run marginal cost may be so expensive that it is best not to try, since the gains would not exceed the cost. (I have yet to see this "burden of proof" type of argument demonstrated. But no matter.)

Such a defense, however flimsy, cannot be deployed to defend other types of averaging of marginal opportunity costs which, apparently, are becoming common in the pricing policies for agriculture. In many countries in the Third World, the government fixes the prices offered to domestic producers of some important agricultural commodities. Such government price fixing often ostensibly reflects politically motivated favored treatment for certain groups. In other

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[1]See, for example, Walters (1968).

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cases, however, reforming governments have embraced the principle that domestic prices should be fixed to reflect the opportunity cost as reflected in world market prices. The ostensible objective is to bring farm-gate domestic prices into line with world market prices—allowing for the cost of transportation of wheat from, say, Kansas, and adding on a supposed "compensating tariff" (of 25 percent, as an example) so as to treat agriculture the same as the proposed protected industry. Note, however, that the price in Kansas does *not* reflect any additional special export promotion subsidies that would nowadays undoubtedly accompany an export of grain from either the United States or the European Economic Community (EEC). In that sense the Kansas price basis is above the marginal opportunity cost. One might argue that this is explicit dumping and so should be shunned in pricing policy; in order to avoid red herrings, this view, although in my opinion fatally flawed, is assumed to be correct for the remainder of this paper.

Smoothing Policies and Moving Averages

The mechanism by which the price in any year is determined, however, typically involves taking a *moving average* of the past three years, the current year, and the futures market quotations of the next year. It is therefore a five-year moving average of market prices.[2] As with all such processes, the effect of taking a five-year moving average will depend critically on the time pattern of oscillations in the underlying series. One would normally choose a five-year moving average to smooth out an underlying five-year cyclical component of the series, as well as the presumed random elements entering into the price in any given year (due to weather, civil unrest, and so on). In order to discuss the effects in a sensible way I shall assume that the average period of cyclical oscillation is exactly five years. This gives an air of verisimilitude since the *average* period of oscillation of the business cycle over the last century is probably in the region of four to five years.

Even more important is the issue of the underlying *trend.* Granted the period of cyclical movement, then the moving average will reveal the trend in prices. Since the middle of five years is mid-year for year three, and since year four is the current year, the moving average will locate the trend of prices *one year before.* Thus, with all the components being well behaved, the procedure will fix government

[2]In practical application there are many problems of valuation, such as the appropriate exchange rate to translate Kansas dollar prices into local currency. These are irrelevant to the main point that is being made in the text.

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prices this year at *last* year's trend value. Unless the world market prices exhibit stationarity, that is to say the trend is neither increasing nor decreasing, this procedure will give an additional bias against adjusting to the trend. In order to avoid confusing this effect with all the others, I shall *provisionally assume stationarity* of the underlying price series.

An Idealized Illustration

A numerical illustration not too far from actual experience may illustrate the process. Suppose the annual price goes through the following sequence:

Year:	1	2	3	4	5	6	7	8	9	10
Price:	80	40	70	90	100	80	40	70	90	100

The five-year moving average is constant at 76. For two years of the cycle where the price is 80 and 70, the moving average is within less than 10 percent of the actual price. But for the boom years it is only three quarters of the market price, whereas in the depths of the recession the moving average is 90 percent above the market price.

Does it make sense to isolate or insulate or "protect" the farmer from the realities of world markets? Perhaps political realities, whatever that may be taken to mean, may dictate no other course. But, whatever the politics may be, it is worth examining the *economic* consequences of such a policy. It is as well to examine the policy consequences first in the case where the moving average has exactly the right periodicity and where it nicely finds the true trend. Next we can examine the consequences of confounded cyclicalities and shifting trends and other unfortunate characteristics of real world price series. Finally we review briefly the historical examples of such smoothing schemes, such as the marketing boards in British West Africa, and the political temptations of such world market insulations.

Giving the "Right Signals"

The usual ostensible argument for MAS (moving average smoothing) is that the price will reflect the long-run trend and so will not give rise to oscillations in gross farm incomes that are thought to be not in the farmers' interest. Further, the steady price of 76 would be the appropriate signal for long-run investment decisions, whereas, were the farmers subjected to the fluctuating prices in the real world, they would probably make the wrong decisions. (In this stylized case, this amounts to the assertion that the farmer cannot do simple addition and carry out his own averaging. One's credulity is much

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strained; even illiterate peasants tend to be numerically rather sharp at least where their own interests are concerned.)

In our previous example, the farmer with the same production costs in each year and the same quantity of output annually would have precisely the same net and gross income over the five-year period—whether there is a MAS of prices or not. The only gain is that of a constant rather than a variable income flow. In many countries this is thought to be a significant improvement since it avoids the farmer borrowing and lending in order to finance a stable consumption pattern. If there are distortions in credit markets this may be a considerable gain. (Although the policy implication surely is to tackle such distortions directly, rather than limit the supply of and demand for credit.) Assuming that administration of such a scheme is costless, and that other things are equal, the proposed smoothing will be a good thing.

Other things, however, will never be equal. Earlier we assumed that, with oscillating world prices for the farmer's outputs, he would not be able to adapt his production to take advantage of high prices or to avoid the price troughs. Even in the short run, and a fortiori if the cycle is predictable, the farmer will adjust his outputs and the amount he produces, stores, or sends to market. Only if the output/market response is near zero or negatively related to price (that is, the supply curve is backward bending for that rather wide price range) are there no gains to be made from allowing world prices to rule. I suspect there is now sufficient accumulated evidence to dismiss such a perverse form of response. Supply curves slope upwards and, even in the short run of a year or so, there is considerable flexibility of supply. The farmer will be able to *increase* his income and welfare by adapting to world market prices. Isomorphically, the consumer will be better off with the variable world market prices than the MAS controlled price, since he will adjust his purchases—substituting into the commodity during the price slump, and economizing, by switching to substitutes, during the price boom. And it follows that if *all* or a sizable number of countries follow this policy of open markets, this will mitigate the oscillation in world prices. In other words this is truly a boost, rather than beggar, thy neighbor policy.

Imperfect Credit Markets

The main rationalization for MAS is that credit markets are "imperfect" or more positively involve large "distortions." Better, it is said, to smooth away the need for credit. Of course, by so doing one

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smooths away a corresponding supply of credit from the private sector. But in any case the *demand* for total credit is not diminished; it is simply transferred to the government. Indeed since the MAS policy precludes the adjustments referred to above, the demand for credit will be *greater* with the MAS than with the open policy. So the argument boils down to a preference for more government borrowing and lending rather than giving the private sector a choice in this process.

Even if one accepted the fact of great distortions in private credit, one should also examine the existence of large distortions in the alternative government credit markets. The issue of government paper, including currency, is associated with obvious distortionary effects—inflation, compulsory government bond and note holdings by banks and other institutions at below-market yields, government credit allocations according to political preference rather than market performance, and so on. Nor can government produce anything comparable to the vast informal private credit market within extended families and other groups which provides for the majority of private credit needs.[3]

It is not at all clear that on balance the distortions are more with the private than the public sector. But even if this be accepted, then it does not follow that the appropriate policy is to shelter producers and consumers of the chosen commodities from the exigencies of credit markets. Surely as a matter of efficiency, if not equity, *all* those who use such distorted credit markets should have somewhat similar treatment to the farmers and consumers of the specific commodities under the MAS arrangement. In the face of ubiquitous distortions the obvious policy is to try to eliminate or modify them; if one cannot do so then consider a ubiquitous subsidy (or tax relief) to all distorted credit markets and calculate the cost/benefit involved. In any case, there is no rational argument for MAS for a certain limited number of commodities.

Shocks and Bends in Trends

We conclude, therefore, that with the simple stylized model of MAS there is little to be gained and much to be lost from such smoothing of prices. We now need to examine rather more complex cases to see whether this conclusion is likely to be modified. First, it is clear that much of the variation in prices is due to "shocks" or

[3]Although I concede that in some countries, where fraudulent conversion of public funds to private uses is on a massive scale, it is possible that the fraudulent funds are channeled into productive uses, albeit in the form of capital flight.

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random effects due to weather, wars, pests, disease, and tastes. The arguments deployed above for the cyclical case carry over, mutatis mutandis, to the shock effects. The only important distinction, on which fortunately little hinges, is that the cyclical pattern could be foreseen, whereas the random effects cannot.

The second complication—a shifting trend—is much more important in practice and in its implications. By the nature of MAS, it will pick up a new trend value only gradually over the five-year period of the process. By the end of the five years, the centered value will track the new trend. It may strike one that five years is a long time for such an adjustment process, since there will be waste, which might be very considerable, over that period. In many cases it is obvious quite quickly that there has been a change in the level or the trend of a price. For example, it was perfectly clear in 1974 that the real oil price was not going to resume its downward trend of the past two or three decades; 1974 was no one-off outlying deviation. A moving average process applied to oil would have delayed the full adjustment until 1979. From the research that has been purused by Bela Balassa on the adjustment to the oil shocks, we know that the quicker the countries allowed the oil price to increase the less costly the adjustment and the fewer the distortions caused.[4] It seems at least likely that such a conclusion would apply to most other important commodities.

Empirical Experience with "Smoothing"

Briefly, we may refer to practical examples of such smoothing operations. Perhaps the best researched examples are the West African marketing boards set up by the British colonial administrations in 1946–48. The authorities stated that the export monopolies would be used to stabilize producer prices to shield producers from short-term and cyclical price fluctuations, and that they would on no account be used for taxing producers and withholding money from them. The outcome was very different and the boards have, for more than four decades, been a major discouragement to wealth creation in the constituent countries.[5] Of course a MAS type of system should in principle prevent any such taxation (or subsidy); but the intention in setting up the marketing boards was exactly the same. Guarantees that the boards would not be used for taxation were reiterated formally to the parliament of the United Kingdom by ministers of the

[4]See, for example, Belassa (1985).

[5]See especially Bauer (1984).

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crown. One may therefore doubt whether the MAS would be resolutely pursued during the high-price boom stage of the cycle. The "ideal" of the MAS is alternating (albeit implicit) taxes and subsidies to equalize the price level. But so far as I am aware, there is no working example of such a nicely balanced system. The political and institutional pressures are such that subsidies or taxes persist for long periods, usually many decades.

Other examples of smoothing operations, usually aligned with buffer stock schemes, are to be found in the recently collapsed tin cartel. The precise reasons for the demise of the buffer stock scheme will have to await the unraveling of their most complicated affairs, but it would not be premature to state that one of the main reasons was to misidentify a *secular* shift in price as a mere *cyclical* oscillation. The cost of servicing the large credit needed to finance excess supply and stocks of tin at the support price proved too much for the resources of the cartel members and their bankers.

With its support levels well above world market prices and the promise of adjustment toward world market prices, the MAS as applied to Third World agriculture recalls the Common Agricultural Policy (CAP) of the EEC. Again the intention was to smooth the prices and supposedly the incomes of European farmers in an adjustment so that eventually agriculture, like industry, could compete more or less freely on world markets. The outcome over the last 29 years has been rather different from this plan.[6]

One of the most poignant aspects of such smoothing schemes is that they are very easy to get into, but very difficult to get out of. Whether they support prices below world market values, as in the case of the West African marketing boards, or above, as in the case of the CAP and United States, the system generates its rents to parties and cliques who find it in their interest to block change, however rational and equitable that reform may be. While informed opinion accepts MAS as an appropriate policy, so will the interested parties deploy such principles to reap the rewards of protectionism (as in the EEC) or confiscation (as in West Africa). MAS provides a veil of legitimacy and intellectual respectability for exploitation and inefficiency.

Conclusion

The thrust of my argument is that, while the instinct of introducing world market prices into LDC pricing policies is entirely laudable,

[6]The United States has also indulged in similar policies for certain commodities, for example, cotton and sugar, in "smoothing" adjustment to world market realities, with effects similar to those of the EEC.

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the practice of smoothing by moving average (or indeed any other such technique) negates and even distorts the benefits to be derived from opening economies to the reality of opportunity cost. Moving average smoothing is not merely a less painful way of getting countries to adjust to opportunity cost on world market prices; it is almost precisely the antithesis. It isolates the farmer from the realities of supply and demand, and gives him and the consumer the wrong signals year in year out. Thus it distorts both production and consumption. MAS is easy to get into, and the longer it goes on, the more difficult it is to change. Moreover, the process lends itself to political manipulation. There is no inherent reason why the moving average process should be five years; equally good arguments can be made for two or ten years. And politicians will adjust the time frame when it serves their purposes.

While the objective should be to allow the reality of opportunity cost to be reflected in prices, there is also good reason to enable anyone to insure himself against the oscillation of prices. This can be done by government eliminating restrictions on forward and options markets—or perhaps by government deliberately promoting such contractual arrangements. There are myriads of possible structures that would enable a farmer to buy degrees of stability in both his output and input prices. Under the MAS, even when operating "perfectly," the farmer has no choice; he has to "buy" the stability of the MAS scheme of prices. World market prices, together with such futures and options that are mutually agreed, will much expand his choice as well as that of many others.

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The Rhetoric of Economic Development

Donald N. McCloskey

Rethinking Development Economics

Peter Bauer has at least the satisfaction of seeing his grimmest prediction come true. As he feared so long ago, economists have on balance hurt economic development, and have hurt it more as the quarrel over equality has intensified. He is not surprised by the contrast between a politicized world and the apolitical Science claimed by the economists in their political advice.

Nor should one be. It is not surprising that an economics taking itself to be social engineering should lose its way. Economics around 1950 gave up social philosophy and social history to become a blackboard subject. In the name of "Science," that magic English word, the scope of economic conversation was narrowed. Economic development gave room to try out the novel way of talking. If the governments of Western Europe proved wary of the less sober among the projects of economic engineering, there were now other governments, and intergovernmental governments, waiting to be dazzled.

They were dazzled by Scientism, a world religion for a time in the mid-20th century. When spelled with a lowercase "s," of course, science itself is as old as thinking, of which it is an honorable type. It means merely French *science* or German *Wissenschaft*, "systematic inquiry." But the religion of Science with a capital "S," a 19th-century English creation, went further: keep facts and values separate, and then discard the values; keep assertions testable, then relax the tests; keep arguments quantitative, then fudge the numbers. The chemist and philosopher Michael Polanyi (a smarter brother to Karl, the economist and historian who was responsible in part for the turn

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to social engineering) called the narrowing rules of Scientism "voluntary imbecility."

The result, as Bauer has seen in his career, was a devaluation by intellectuals of voluntary exchange. After all, what is so fine about voluntary exchange if crushing it can produce the wealth of nations? And why should historical and philosophical doubts that the wealth arises from planning be entertained even for a moment if a sweet diagram can prove an externality? The treason of the clerks arose from their religion.

What then is to be done? We could hope that the East Asian successes would settle the matter. They will not, no more than the successes of the 19th century settled the matter in favor of laissez-faire. Religions are matters of words. The Fabian historians of the Industrial Revolution knew this, as did the New Deal historians of American internal improvements: those who write the history write the future, too. Rethinking development economics requires rewriting the words.

I disagree, therefore, with the contrast announced in the title of one of Peter Bauer's books on economic development, *Reality and Rhetoric* (1984). The "reality," I say, is itself a matter of words. We cannot speak persuasively without being rhetorical, and by our rhetoric in economic development we make our worlds, East, West, or Third. The meaning of "rhetoric" here is its ancient and honorable one, not the meaning current since the 17th century, of rhetoric as an ornament fooling or pleasing the reader. On the contrary, rhetoric is the whole art of argument, from metaphor to mathematics. As Bauer has been the first to understand, economic development is drenched with metaphor. He has remarked that the metaphor of the Third World was born with foreign aid and anticommunism, and would disappear without them. And we economists make a world of "production functions" and "human capital," embodied in mathematics, in places where lay people see only factory workers and schoolhouses. As Deepak Lal (1987) observes, we are all rhetoricians, we scientists and policymakers together.

The obvious point I am making is that for the study of economic development, and in particular for discussions of equity versus efficiency, words have consequences. By the mere act of speaking of equity versus efficiency, for instance, we import into the argument, as though it were uncontroversial, a utilitarian ethic. We are invited to think of trade-offs between the one and the other, U = U(Eq, Ef), in which Efficiency is the size of national income, regardless of how it is achieved, and Equity is measured by the distribution of income and not by the distribution of rights. This is not "wrong"; it is simply

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one style among many, some more persuasive than others. The point is not that one form of speech in the discussion of equity in development is "reality" and the other "rhetoric." Rather, the point is that all forms of speech are rhetoric, and no less right or wrong on that account. We ought to be conscious of what we speak, and therefore must be conscious of how we speak.

Rhetoric in Economic Development

I cannot pause here to go into the justifications and criticisms of this way of looking at economic science, which I have done elsewhere (see McCloskey 1985). Here I wish only to illustrate the work that words do in economic development. As I said, Bauer does a good deal of the work himself, though burdened with the false notion that if one could strip away the rhetoric one could see plainly the reality. I detect in his writings a rhetorical sensitivity coming from an education in the ancient languages. At any rate he feels the power of words more than does someone who has limited his education to the solution of programming problems.

Bauer notes, for instance, the danger in the metaphor of "nation building," a handsome neoclassical building in which political prisoners scream in the basement. The figure of a building treats people as "lifeless bricks, to be moved by some master builder." Nation building is not "merely" a metaphor, "mere" ornamental rhetoric, but a political argument put into a word.

Consider more broadly the array of metaphors taken from sport, as in the "goal" of equity or the government as "referee." These are especially popular among Americans, who, good-hearted all, like the notion that no one really gets hurt (Europeans will use metaphors of war and conquest in similar cases). The ideal is team play, joining together to score a goal against the North or, in a more mellow way, to achieve a "personal goal." Whenever we hear that "we" should do something we should watch for the team metaphor in action. The best that human frailty is likely to achieve along this line is Lester Thurow's recent book, *The Zero-Sum Solution: Building a World-Class American Economy* (1985). The book treats income and wealth as being extracted like football yardage from other people, especially the Japanese. As Karl Brunner (1987) points out, the image of income as a fixed manna from heaven to be shared out is an argument persuasive to many, even to many economists. The zero-sum image has always been the main argument for mercantilism, and now figures heavily in the talk of North and South.

The North, of course, is meant to feel guilty that by the grace of God it gets more of the manna than the South. Bauer has treated at

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length the use of the notion of "our" guilt as a justification for compulsory charity. Murray Rothbard has recently pointed out that American Progressives (ca. 1910) were disproportionately the sons and daughters of postmillennial Protestant clergymen. Clergymen and upper-middle-class intellectuals delight in the transformation of mea culpa into nostra culpa, prejudging in a word the weighty question of whether charity should be individual or social.

The word *problem*, likewise, answers a question before one thinks to ask it. For example, many reputable economists argue that the balance-of-payments problem is not a problem at all, in the sense of something requiring that "we" find "a solution." Yet everyone else is exercised about the alleged problem. I have the impression that the 19th century invented the talk of a "social problem," an "economic problem," and the like, problems for which finally the Great Geometer in Washington or London was to provide a solution, with compass and straightedge. Max Hartwell speaks of the rhetoric of British parliamentary inquiries in the 19th century as defining problems where no one had seen them before. It is not done with mirrors; this or that condition does exist. But it is done with words. Someone who has persuaded you to speak of inequality of income as a problem has accomplished the most difficult part of the task.

The essays in this volume themselves contain examples of the rhetoric of economic development. The very word *development* is a metaphor, of course, limiting our thinking at the same time it makes thinking possible. "Economic growth" sounds better than "economic change," and "change" better than "losing existing jobs," but they are translatable one into the other, implying different policies. Economists are not usually conscious of the difference the words make. A self-conscious metaphor has a different effect from an unselfconscious one. An explicit metaphor does not bite.

Metaphors are not the only rhetorical matters. Alan Walters (1987) makes, as Bauer does, the point that the main audience for the main ideas of economics, as distinct from the technical gingerbread, is not the economics profession itself. It is the City or Whitehall or Fleet Street, not the seminar at Cambridge, that hears and uses the idea of monetarism or free trade. Awareness of the audience has characterized rhetorical theory since Aristotle. The theory itself uses a metaphor of a speaker before the Athenian Assembly, which has proven a useful way of finding out what is going on in a country report by the International Monetary Fund or in a technical article on trade policy. The Greeks had it right: the study of rhetoric is not a way of attacking a speech, necessarily, but is always a way of understanding it.

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Consider in a rhetorical way, for instance, Alvin Rabushka's (1987) illuminating essay. I say immediately that I agree with nearly every word Rabushka writes there. A rhetorical analysis, to repeat, is not a euphemism for debunking. But consider how the essay seeks to persuade. One can see immediately that it appeals to a rhetoric of "What The Facts Say." Rabushka knows that facts do not "say" anything unless human questions are posed to them, that the questions depend on the predispositions of the questioner, and that anyway the subset we call "The Facts" (out of the unbounded set of particular statements we might make about the universe) is our selection, not God's. Yet the move is effective. Appealing to what the logician so ill-advisedly calls the "fallacy" of *post hoc ergo propter hoc,* Rabushka points to his facts to state that free countries do well. But this statement is a "fallacy" because, after all, it is not based on a properly identified econometric model set beside a proper random sample of events. What the logicians call fallacies are what most of us call arguments, more or less appropriate to the matter at hand. That Hong Kong had a light-handed government (that is, not a light-fingered one) and *then* prospered does not have the demonstrative force that Scientism seeks. But of course such a statement—supported by facts—persuades. It should, while making room for a rebuttal.

Even "mere" style is an argument. The forthright character in the writings of Bauer and in the writings of George Ayittey (for example, Ayittey 1987) does not please all audiences, but makes an appeal to *ethos,* character. It announces that the writer tells it like it is. A more accommodating style would make an appeal to the *ethos* of moderation or of practicality. A style of mathematical precision would make still another ethical appeal. The euphemism of the development bureaucrat—"extra-budgetary revenues," for instance—soothes an audience worried that something might after all be said.

Conclusion

Development economics, in short, has a rich and unexamined rhetoric. Deepak Lal (1987) observes that in the past few years the rhetorics have begun to converge, converging indeed on the arguments of Peter Bauer. The story of Bauer's resurrection follows William James's three stages in the rhetoric of academic disputes: at first what Bauer says is plainly false; then it is trivially obvious; and finally it is so true that we, not he, invented it.

The last word on rhetoric in economic development, though, should be accorded to Cato the Elder. Some 2,200 years ago he captured in a phrase how rhetoric, which is inevitable, must be used if it is to be

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good. There are no methodological protections against speaking falsely. We cannot assure good results by mandating this or that model or metaphor. The final protection, he argued, is human goodness. The arguer, said Cato, must be not merely a man skilled at speaking, for this is a mere advocate, a showman. He must be a *good* man skilled at speaking, *vir bonus dicendi peritus*. It is such a man we honor today.

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COMMUNICATIONS

Are Teleological Rights Theories Utilitarian?

Tibor R. Machan

In his essay "Rights, Contracts, and Utility in Policy Espousals," Leland Yeager (1985) argues that I am committed, along with several other unlikely candidates, to "tacit utilitarianism." As Yeager (p. 288) puts it:

> Tibor Machan, avowedly a rights theorist, is another tacit utilitarian. Instead of simply postulating or intuiting rights, he inquires into the political principles of a good society—good for man's pursuit of happiness or perhaps excellence, given his nature and his character as a moral agent.

Yeager supports this claim by noting that the position I hold is defended on grounds that persons possess rights because only a society in which rights are respected and protected makes it possible for human beings to choose to pursue (or not to pursue) their happiness, the goal that is their moral responsibility to achieve as fully as they can manage.

Let me make clear that Yeager has not misquoted me—indeed, his entire paper is a model of good scholarship from the point of view of doing full justice to the views he explores, given the limitations involved in any kind of journal writing. Rather I want to take issue with Yeager's conception of utilitarianism, which I consider far too broad to warrant the label he uses for it.

Briefly put, Yeager seems to regard all teleological normative theories—ones that hold that principles of morality are guidelines for pursuing some supremely good end or goal—as utilitarian. This,

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I would argue, obliterates significant distinctions and nuances, ones that may secure the success of such a teleological theory or condemn it to failure.

Utilitarianism is by now one of the most refined normative theories discussed by philosophers, economists, decision theorists, and others concerned with standards of conduct and institutions. It would be impossible to give a full treatment to the diversity of this position here. Suffice it to point out that first and foremost utilitarianism is a value theory—a conception of what the good is in human or sometimes even nonhuman life. Some idea of the nature of the good is provided in most utilitarian viewpoints, although in certain cases it is a rather open notion—for example, that offered by G. E. Moore. What is crucial, however, is that utilitarian value theory avoids one of the central concerns of moral philosophy, namely, that of ultimate moral agency.

From Aristotle's *Nicomachean Ethics*, through Kant's *Critique of Practical Reasons*, all the way to Ayn Rand's *The Virtue of Selfishness: A New Concept of Egoism*, a central concern of many moral philosophers—as distinct from those such as Hobbes, Spinoza, Hume, and Mill, who dealt mainly with the issues of value theory (and only indirectly with the matter of personal responsibility for seeking values)—has been the role of volition, including the faculty of uncompelled reason, in ethics or morality. Value theory is interested only in answering the question "What is the good?" It is secondary to it what implications this has for human choice, although of course it is a crucial concern of many value theorists how decision-making should accommodate the answer to that question. But there is a difference between choice, as the initiation of conduct, and decision, the selection from among alternative courses of conduct.

Some who were concerned with agency—for example, Kant—went so far as to reject any association with ends where morality is concerned, so as to avoid the taint of determinism at all cost. They reasoned that by tying ethics to some good end the central role of wanting to be good for the sake of goodness alone would be completely lost. After all, good ends are merely empirical and one should not rest ethics on such uncertain matters as are known by way of contingently true science. We need an *a priori* ground for morality, they argued.

Utilitarians, in turn, argued that no sense could be made of the idea of good if it is so far removed from the actual, empirical world as Kantians would want. They simply could not accept the separation of morals and empirical values. But the price they paid for this is the

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absence of a solid doctrine of personal moral responsibility in value theory.

J. S. Mill, among others, was committed to denying the doctrine of free will, as were most scientifically minded philosophers. Given the influence on them of mechanistic science, it seemed to them wholly untenable to suppose that a natural thing such as a human being could possess a sovereign will, autonomous choice, or whatever one might wish to call a free will. They were aware that philosophers of the scientific age who did embrace free will compromised naturalism—for example, à la Kant's separation of the noumenal and phenomenal worlds.

In any case, the main virtue claimed for the neo-Aristotelian ethics and its Objectivist politics is just that they manage to reconcile science and agent-morality.[1] Accordingly, the role of the individual person's choice to act in attaining the human good is paramount, and the natural rights defended in this outlook are essentially a necessary condition for the very possibility of moral conduct in a social context. Granted that every person's moral purpose is to attain happiness, and granted that a free society is a necessary condition for their accomplishing this as far as that is possible in human existence, the free society is insufficient for purposes of securing happiness for human beings.

If what Yeager is arguing is that natural rights theorists such as those who have taken Rand's ideas very seriously—myself included—defend the free society as a necessary prerequisite to attaining happiness, he is right. They do. But does this make them utilitarians? No. They are too concerned with the issue of agency in the moral life of individuals to be so identified. For them it is vital that any human happiness is to be tied to a choice made by the agent who is to be happy. For utilitarians this is not vital, even though Mill, quite incongruously from his own broader philosophical point of view, insisted on political sovereignty.

In short, what concerns the natural rights theorists of the sort I am is that every individual possess the right to free, uncoerced, uncompelled (by others) action to do what is good, that is, conducive to his or her happiness as a human being. This means that everyone needs to be free to seek happiness on his or her own initiative. This kind of ethics and politics will stress rights far more vigorously than will utilitarianism, whether simple or complicated. I also regard its defense

[1]The most accessible statement of this occurs in Nathaniel Branden (1972). See also Tibor R. Machan (1974). For a technical development of the idea by a psychophysicist, see Roger W. Sperry (1965; 1976).

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of the free society more theoretically adequate, mainly because it rests on sound grounds.

There is a great deal more to the story, of course, and I have elsewhere tried to spell out the details, as have others who advance the libertarian natural rights thesis.[2] The central point to be made here is that not all moral and political theories that are concerned with goals or ends as the *summum bonum* need be classified as utilitarian. There is more to a teleological system of ethical and political norms than a concern for good consequences. It is also concerned with the agent who produces those consequences. It is in large part because of this latter concern that such a teleological viewpoint stresses the negative (natural) individual rights to life, liberty, and property we find defended in the neo-Aristotelian system of Objectivism.

Yeager is correct that happiness is of paramount concern to me in the defense of individual rights I find most sensible. But this happiness must come about by way of the self-determined actions of the persons whose rights I am concerned about. That is not a concern associated with the mainstream utilitarian defense of the free society.

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[2]See Machan (1982a; 1982b; 1985; 1987).

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On Leland Yeager's Utilitarianism: A Comment

Hartmut Kliemt

Leland Yeager's (1985) essay, "Rights, Contract, and Utility in Policy Espousal," contains convincing criticisms of natural rights doctrines as well as of contractarianism. Nevertheless, I have some reservations concerning Yeager's own "utilitarianism." From a meta-ethical point of view these reservations and my own preference for James Buchanan's meta-ethical starting point—though not his contractarianism—should become quite clear. I will argue that, though accepting most of his critical points, we should not follow Yeager on the slippery slope of what I will call cognitivism and universalism. Contrary to the usual line of argument it is not for specific limitations of economic theory but rather for systematic reasons of ethical theory itself that we should stick to noncognitivism, subjectivism, and relativism.

Economics and Ethics

Ethics is as much a theoretical subject as is economics. The term "ethical theory" seems to be perfectly legitimate, though I do not share the view of most ethical theoreticians that the ultimate foundation of ethics rests on "knowledge" about right and wrong. Instead I subscribe to "subjectivism," stating that in the last resort all normative judgments are "hypothetical" in the specific sense of being valid only in relation to ends, values, or aims. It can be known whether these aims, ends, or values exist in individuals but not whether rightly or wrongly so—at least if we concentrate on ultimate aims, values, or ends. Ethical theory ultimately cannot be moored to knowledge of right and wrong, only to factual preferences for certain states of affairs.

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The latter view may be dubbed "noncognitivism" in opposition to the former view, which for convenience may be called "cognitivism." Using these terms in this manner seems quite natural and more appropriate than the systematically misleading, though more conventional, usage of the terms. ("Cognitivism" and "noncognitivism" typically are used to express a thesis about "ethical language" and its claim to truth.) A theory of ethics is possible even if, as I would claim, noncognitivism (in my usage of the term) holds true. Clearly, if some noncognitivist ethical theory is to claim truth for its results, this claim cannot refer to the "rightness or wrongness" of ultimate aims, ends, or values as such. The results basically must be restricted to means-ends relationships or hypothetical directives of prudent behavior. There is no clearance for nonhypothetical statements of rightness or wrongness that are meant to hold independently of the aims, ends, or values of individuals (not mentioning again their "passions," "interests," "desires," and so on).

According to the noncognitivist view, a theory of ethics cannot aim at the "categorical" justification of norms, directives, or imperatives. It cannot claim any validity for results independently of "hypothetically" presupposed ends, aims, or values of the *addressees* of the justification. Therefore all *justifications* of norms are *relative* or "ad hominem" in this specific sense. The derivation of "an ought" within ethics therefore presupposes an "is" in that aims, ends, or values ultimately must be "given" (see Hazlitt 1964, ch. 3). In this respect noncognitivistic ethics and economics do not differ. The ethical skeptic therefore should look at economics as the twin—or even the Siamese twin—of his own theory, and conversely for the economist.

To begin with the economic side, it may be stated that the world view of economists seems to be biased by a kind of professional skepticism toward any claims of knowing right from wrong in practical matters. From their own subject economists are used to being restricted to modes of argument that may be formulated in terms of hypothetical imperatives. To give categorical recommendations about what should be done regardless of the ends, values, or aims of the addressees of the recommendations is rejected as violating the rules of correct scientific reasoning. As far as they are part of the realm of their own study, economists are taking values as being something entirely subjective. Therefore, they usually accept that they have no scientific warrant to go further than recommending efficient strategies as means for reaching given ends contingently shared by some subjects. The ends, values, or aims must be given as a matter of fact, and, therefore, theoretical results about means-ends relationships

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only apply under the provision that somebody in fact shares the presupposed ends, values, or aims.

Of course, there are economists who outside of economics do not subscribe to subjectivism or ethical skepticism. But even these theoreticians usually would concede that judgments about ultimate ends, values, or aims are much more precarious than those about "instrumental or derived values." One can therefore roughly divide economists into two classes: (1) those who stipulate that ultimate values are simply matters of taste or, less radical, that they are in the last resort subjective and all justifications are relative; and (2) economists who, though not accepting that ultimate value judgments are subjective, nevertheless would not regard them as a proper subject of economics and therefore delegate problems of ultimate values to ethics. Those economists who insist on nonrelative or nonhypothetical justifications of normative judgments *within* economics itself seem to be few. All seem to agree that economics as a science should be "value free" in the sense of being free of cognitivistic claims of the knowability or cognitive justifiability of ultimate values.

On the other hand, it may seem quite natural that those who, except for their professional attitudes as economists, are *not* ethical subjectivists or skeptics should regard at least some ultimate value propositions to be scientific findings of ethics. It seems to be quite incoherent for such economists, then, to require that "ultimate" value judgments be left out of economics as irrational or unscientific. At least there could be a kind of "science of values" according to their own view. Why, one may ask then, should economics not take over results of another theoretical discipline like ethics, which is a close scientific neighbor anyway? Even if ethical theory still may lack maturity there seems to be no reason for the cognitivist (in my sense of the term) to exclude a priori its results from economics. It would rather seem appropriate to treat ethics roughly in the way as some fields of sociology, which have not reached the stage of a mature science either.

Thus, economists who outside of their field subscribe to cognitivism would expect too little from ethics—judged against their own meta-theoretical premise—should they reject the possibility of "importing" some fundamental noninstrumental value judgments into their own discipline. From this point of view, natural rights theorists as well as their critic Yeager do the right thing. There is disagreement among them. But, from their point of view it is a disagreement on matters that may be rationally discussed in broadly the same way as other subjects of scientific interest. (In this respect, see Yeager's reference to "fallibilism" [1985, pp. 263–64, 268–69].)

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Again, many of those economists who stick to the value-skepticism or subjectivism characteristic of economics seem to expect too much from ethics. They seem to think that their own meta-ethical outlook implies some material values. This becomes clear if, as may be frequently observed, it is claimed that libertarianism, a certain kind of contractarianism, antipaternalism, and the like are logical consequences of noncognitivism. Indeed, it has to be conceded that from skepticism about the knowability of what is ultimately right or wrong there might stem some psychological tendency toward political libertarianism, contractarianism, and antipaternalism. But these political preferences—these value judgments—follow neither as logical nor as analytical inferences from descriptive meta-ethical premises as that of noncognitivism or, for that matter, subjectivism and relativism. Furthermore, it is not true that only the skeptic could be a consistent liberal in the proper sense of that term. Those opposing skepticism may claim that liberalism is simply correct or that it may be *known* that one should be tolerant and respect the rights of others.

Thus, it is in no way a logical or analytical truth that those claiming to know what is right or wrong must tend to impose it on others. Further, if it is true that people more strongly support what they claim to know than what they regard as mere subjective preferences, then it also should be expected that a cognitive claim to the rightness of libertarianism and tolerance will provide additional force to these values.

Taking into account what has been said so far, it seems clear that those adhering to liberal forms of political organization will have to argue for them on their own normative terms. A kind of genuinely ethical argument seems unavoidable. I fully agree with Yeager here. Nevertheless, being a meta-ethical noncognitivist, I also view much of traditional ethics with more skeptical eyes than does he.

Most of ethical theory does not start from a skeptical meta-ethical position. Contrary to that, those ethical theorists as Thomas Hobbes, David Hume or, more recently, John Mackie, who are skeptics of a kind, argue from individual aims that "are there" as a matter of fact. Discussing fundamental institutions of social organization, they proceed from aims or ends toward hypothetical imperatives of prudent behavior in much the same way as economists do in their field. An economist with an interest in basic political values should therefore tend to look for methods of discussing fundamental value problems of society within economics itself, or at least within a meta-ethical framework consistent with the main thrust of economic theory.

Many economists have tried to do that all along. Perhaps the most striking example in the present context would be legal philosopher

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H. L. A. Hart's (1961, ch. 9) defense of what he calls "the minimum content of natural law." Starting from certain elementary empirical facts of human nature, Hart argues that no society could survive without some basic legal institutions, such as rudimentary forms of property rights. He explicitly acknowledges that his argument would not hold true for a club of self-murderers. The addressees of his argument as a matter of fact must want to survive. And once survival is presupposed as the basic driving force, Hart relies on this feature of human nature to justify the proposed institutions, rules or norms. That is, *given* the self-interest of individuals to survive, Hart shows that the proposed institutions, rules or norms are instrumental relative to that "given aim" of individuals. Yeager (1985, p. 277) clearly would classify such a justification as "utilitarian." But in doing so he blurs essential distinctions between a cognitivist and a noncognitivist approach and in turn conceals his own tacit "intuitionism."

Yeager's Tacit Intuitionism

Yeager attacks the advocates of a natural rights doctrine for either following intuitions without offering any argument or becoming tacitly utilitarian if arguing at all. As far as he refers to his own very broad conception of utilitarianism, he certainly is right. But what kind of argument can he offer for his usage of the term "utilitarianism" and his own utilitarian point of view?

Yeager does not distinguish between a universalistic and a particularistic approach to the evaluation of norms, rules, institutions, and behavior. Admittedly, some theoreticians, notably the leading utilitarian J. J. C. Smart (1967), would call any consequentialist ethical theory a (broadly) utilitarian one. And so does Yeager. Nevertheless, utilitarianism in the narrow and (I think) "proper" sense of the term is universalistic in two respects. First, it refers to the consequences for *all* human or even sentient beings concerned. Second, such a utilitarian justification does not allude to the specific interests of any particular addressee or group of addressees of the justification.

To make both variants of universalism more clear, consider norms for drug regulation in the United States (see Gieringer 1985). Should the Federal Drug Administration (FDA) have the legal power to prevent new drugs from coming on the market or should it be confined to enforcing certain norms of informing the consumer about risks? As a universalist in the first sense, the utilitarian would consider potential harms and advantages from having access to a drug and potential harms and advantages from not having access to it for all American consumers. In principle the utilitarian also should take

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into account the welfare interests of employees of the drug industry, of the FDA, of consumers and producers indirectly influenced in other nations like India and, possibly, the interests of such other sentient beings as animals, which are used or abused for testing drugs. *All* interests concerned are taken into account.

As a universalist in the second, justificatory sense, the utilitarian should address any competent impartial spectator (for the degree of competence required, see Rawls 1951). The justification is meant to hold true independently of contingent aims and desires of the addressee of the justification. It is not only justified relative to the specific aims of an addressee; it raises a universal claim to the rational consent of all individuals independent of their specific point of view. At least if they would take an impartial point of view, they would be obliged to accept certain justifications as valid. Therefore the claim to validity is intersubjective and universal in the sense of not being attached to a specific point of view and status quo of individuals.

Someone can be a universalist in the first sense without being a universalist in the second sense. He regards the institutions, rules or norms as instrumental to some more fundamental aims, or he has the contingent aim to consider all interests of all other individuals or even of all sentient beings. Such a person still can subscribe to particularism in the second, justificatory sense, acknowledging that somebody who would not share the appropriate ends, values, or aims would have no good reason to follow universalistic precepts in the first sense. One also might be a universalist in the second sense and—although this may seem highly improbable—accept that not all individuals are to be taken into account, or at least not equally.

In identifying consequentialism and utilitarianism, Yeager leaves open the problem of universalism in the first sense of that term. Nevertheless, he evidently seems to take for granted universalism in the second sense. But why should we regard particularism in the justificatory sense or, for that matter, noncognitivism to be mistaken? First, if this claim is meant to be intuitively self-evident, I must admit that I do not have access to this intuition. Second, if it is argued that moral claims as moral claims are universal by definition (universal in the second sense, but according to this position presumably in the first sense too), then it still may be regarded as an open question why we rationally should be committed to obey only such universally justified precepts (see Singer 1973).

As far as the epistemological status of claims of knowledge in practical matters is concerned, we would have strong reasons to stick to particularistic or noncognitivistic approaches to the justification of normative precepts. Social reality seems to exhibit a much greater

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diversity of "values" than we can find, for instance, with the perception of such "secondary qualities" as colors. Even if on the level of ultimate values this impression or argument from (cultural) "relativity" should be deceptive, values as an intersubjectively accessible property of reality still would be quite peculiar phenomena (see Harman 1977, chaps. 1–2; Mackie 1977, chaps. 1–2).

On the other hand, undoubtedly noncognitivism is not a self-evident position either. My references to Mackie's and Harman's work cannot serve as a substitute for a convincing argument for such a position, which I introduced more or less dogmatically. But Yeager offers no argument to the contrary. Therefore, I still would feel quite safe in joining the second camp of the two groups of economists discussed above and regard the usual noncognitivist intuitions that are widely shared by economists in their professional attitudes as more convincing even *outside* the ordinary economic realm. Yeager implicitly presupposes that ethical argument should proceed along cognitivistic lines and should incorporate something like an ethically impartial point of view. This might be an intuitively appealing norm of ethical argument. But, besides this intuition of right and wrong in matters of practical argument, can we offer anything systematically supporting it that would not boil down to a thesis about ethical language or a definitional route of escape? Even if Yeager could eventually offer some arguments in favor of his justificatory universalism and cognitivism, it also should be quite clear that the argument in his paper leaves untouched the meta-ethical noncognitivism of Buchanan—though not the normative ethical conclusion Buchanan draws from the meta-ethical premise.

Objections Against the Noncognitivist Alternative to Yeager's Utilitarianism

Yeager states that "it is antiintellectual simply to chalk disagreement up to irresoluble emotional differences" (1985, p. 261). He points out the role of logical and factual analyses within the discussion of value problems—and rightly so, as his own essay demonstrates. Nevertheless, it is important to restrict the scope of rational discussion further or at least more explicitly than Yeager has. Even if "bona fide disagreements seldom if ever center on fundamental values, openly avowed" (Yeager, pp. 261–62), the kind of meta-ethics we accept is of some importance because our modes of argument will differ.

The noncognitivist naturally would argue from a broadly Hobbesian point of view. For instance, in discussing basic institutions of

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society he would have to refer in the last resort to the given interests (whether altruistic or egoistic) of the addressees of his argument. His defense of a certain institution would have to show that it is instrumental to the pursuit of these interests. The "as if" or "conceptual" agreement of a normal contractarian argument as well as the impartial point of view implied in Yeager's argument would not be important. The status quo would be the essential part of the justification. Factual, not ethical, preferences (for example, in Harsanyi's sense) form the basis of the argument.

Buchanan's (1977) "Hobbesian interpretation of the Rawlsian difference principle" outlines quite well this kind of an argument, which hardly transgresses the limits of economic theorizing. Three objections usually are raised against such a limited ethical theory. First, it is argued that it is necessarily egoistic. This argument, however, is clearly false. All kinds of preferences are admitted as premises of hypothetical justifications. How widely they will be shared as a matter of fact is a different problem—though crucial for the scope of potential addressees of the argument. Second, people accuse those holding such a position of implying ethical nihilism, that is, a meta-ethical noncognitivist could not criticize a Hitler or a Stalin. But if one does not draw normative consequences from noncognitivism, which cannot be validly inferred from it anyway, this criticism is evidently mistaken. Those addressees of an argument who will not share what in their view are abominable primary values can very well—and consistent with the meta-ethical premise of noncognitivism—be informed about how they should prevent others from realizing these values. To them, norms will be justified which guide them in exerting an externality on others sharing other values. Third, it is argued that noncognitivism eventually leads to irrationalism in normative argument. To this the genuine noncognitivist can only answer that this accusation begs the question because it presupposes exactly that form of rational argument about ultimate values that he rejects as impossible.

Still, one might wonder whether there cannot be some place for traditional ethical argument incorporating an impartial point of view even with a noncognitivist meta-ethical framework. Basically there seem to be two ways to accomplish that task. First, we could argue that alluding to an impartial point of view would make ethical argument itself more persuasive and thus more successful. This would lead to the classical sophistic evaluation of arguments according to their persuasive force rather than according to their validity. Second, one might remind us that the modes of thinking about normative institutions form an essential part of the institutions themselves.

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Thus, it might possibly be shown that it would be in our long-run interest (this is, instrumental to some ultimate ends, values, or aims that are factually shared) to institutionalize a guiding social ideology requiring that at least in public we should discuss normative proposals from an impartial point of view.

These are interesting, classical problems with no easy solutions. But, by way of a final observation, I would point out that if seen in this light, contractarianism as a "public ideology" might enter the picture again. At least in comparison with Yeager's own universalistic position and regardless of his sound criticisms, contractarianism would not be at a principal or a priori disadvantage. All would depend on empirical analyses about the working of ideologies or modes of interpreting and discussing the normative and institutional world.

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Reply to Professors Machan and Kliemt

Leland B. Yeager

Utilitarianism invokes comparisons among alternative sets of institutions, laws, traditions, patterns and maxims of behavior, and traits of personal character. It approves or disapproves of them according as they tend to support or to subvert the kind of society that affords people relatively good opportunities to succeed in making satisfying lives for themselves. Institutions and practices that facilitate fruitful cooperation among individuals pursuing their own diverse specific ends score ahead of ones that make for destructive clashes. "Social cooperation" (so called by numerous thinkers in the utilitarian tradition, as I noted in my article of 1985) is so nearly essential to individuals' success in their own diverse pursuits that it is a nearly ultimate criterion of institutions, ethical rules, and so forth. On this criterion, truth-telling and promise-keeping command approval. So do respect for justice (as John Stuart Mill emphasized in *Utilitarianism*, ch. 5) and respect for property rights and other human rights. So, within limits, do certain kinds of honest partiality toward oneself and one's compatriots, friends, and associates.

Positive analysis—economics, political science, sociology, psychology, and even the natural sciences as well—can contribute much to judging whether particular institutions, practices, and character traits tend to serve or to subvert social cooperation. But social cooperation is only a *nearly* ultimate criterion. It is instrumental toward something more completely ultimate, something simply taken as desirable because no further argument for its desirability is possible. I can only take stabs at labeling that ultimately desirable "something": it is individuals' success in making good lives for themselves, or fulfillment, or satisfaction, or life appropriate to human potential-

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ity. No single word is an adequate label; but when a single word is required, "happiness" is the traditional choice.

This is utilitarianism as I understand it. The supposed utilitarian who goes around looking for opportunities to frame and execute innocent men to pacify raging mobs (or to torture redheads for the amusement and greater net satisfaction of the multitude, or to approve of rape when the rapist's pleasure outweighs the victim's distress) is an invention of superficial critics. Real utilitarians stress why respect for truth and justice and individual rights is essential to a good society and so to human happiness. The popularity of cheap shots at utilitarianism is, by the way, a puzzling phenomenon. What good are phony victories over a contrived, caricatured version of a doctrine one has not taken the trouble to understand?

Utilitarianism is sometimes criticized as being all-encompassing to the point of vacuousness. (This seems to be one theme of Professor Machan's criticism.) Yet it is not vacuous; alternatives to the criterion of "happiness" are conceivable. They include conformity to the will of God, somehow ascertained; or performance of duty for duty's sake, even if only intuition rather than analysis of consequences has entered into the identification of duties; or conformity to intuited ethical precepts for conformity's sake, even though any consequentialist inquiry into the bases of those precepts is scorned; or respect for individual rights that have simply been postulated rather than argued for on utilitarian or any other grounds, and again regardless of consequences; or conduciveness to the flourishing of the highest or noblest specimens of the human race, however ordinary people might then fare (a view sometimes attributed to Nietzsche, how rightly I do not say). Or instead of taking the "happiness" of people in general as the criterion of institutions and so forth, one might conceivably adopt the happiness of oneself or of some other specific person (say Gordon Tullock, to carry on a kind of joke that Tullock himself has used).

The conceivability of these alternatives shows that the utilitarian criterion is not vacuous, while their implausibility strengthens the utilitarian case. Anyone who knows a plausible and appealing alternative to the utilitarian criterion is hereby challenged to state it clearly.

Professor Machan stresses everyone's need "to be free to seek happiness on his or her own initiative." His brand of ethics and politics stresses rights vigorously. "[H]appiness is of paramount concern to [him] in the defense of individual rights [he] find[s] most sensible. But this happiness must come about by way of the self-determined actions of . . . persons. . . ." I agree—positive analysis

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leads to these judgments—and I see little or nothing of substance in ethics that Machan and I actually disagree about.

We disagree, if at all, on what label to apply to doctrines we share. I have used the term "utilitarianism" so far because it is historically warranted—because a favorable attitude toward utility, broadly conceived, is the fundamental value judgment involved—and because abandoning the term would seem like an unwarranted concession to superficial critics. But if someone can come up with an equally descriptive and more generally acceptable label, fine. How about "eudaimonism"? (Machan and I do applaud much in Aristotle.) I doubt that "eudaimonism" will fly, but let's see.

Warning against my supposed "cognitivism and universalism," Professor Kliemt recommends "noncognitivism, subjectivism, and relativism" instead, and apparently even "ethical skepticism." He argues, if I read him correctly, that ultimate value judgments cannot be scientifically validated. Well of course they can't: not being amenable to further argument is what "ultimate" means in this context. No one can prove that general happiness is preferable to general misery. But ethical skepticism hardly follows from Kliemt's own perplexity in the realm of ethical discourse. The judgment in favor of happiness is pretty tame and noncontroversial, and much scope exists for factual and logical investigation into what institutions and ethical precepts and character traits serve or undercut happiness.

Admittedly I may not have answered Kliemt's points; I may not even have grasped what they are. His comment does strike me as a remarkable stringing together of abstract nouns and phrases ("universalism in the first sense" and "universalism in the second sense," for example).

I'll summarize. Utilitarianism is an approach to ethics—to the appraisal of institutions and rules and character traits and the like—that combines factual and logical analysis with a fundamental value judgment in favor of what the word "happiness" alludes to, however inadequately. Utilitarianism is not so broad as to encompass all approaches to ethics; others, based on alternative fundamental value judgments, are conceivable, although unappealing. Yet utilitarianism has somehow gotten a bad press, as the comments by Professors Machan and Kliemt again illustrate. (The unduly shallow, act-oriented versions formerly to be found seem to have offered critics a target; but I still wonder what, except worthless triumphs, is to be gained by blowing down what are hardly more than straw men.) Another name for utilitarianism ("eudaimonism"?) might serve communication, but the merits of the doctrine itself would remain unaffected.

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Durable Tax Reform

William F. Shughart II

Introduction

In his January 1984 State of the Union Address, President Reagan called on the Secretary of the Treasury to develop a plan "to simplify the entire tax code, so that all taxpayers . . . are treated fairly." The Treasury Department interpreted the President's directive as requiring it to achieve two objectives. These were to improve taxpayer compliance with the tax code and to broaden the tax base so that personal tax rates could be reduced.[1]

As part of its efforts to develop a tax simplification plan, the Treasury Department held a series of public hearings at various locations around the country during June 1984.[2] Testimony at these hearings brought forth a wide range of reform proposals, including simple taxes, flat taxes, and no taxes. Plans were advanced to change the basis of taxation to something other than income (consumption expenditures were a popular alternative), and some individuals (many of whom seemed to be tax accountants and attorneys) argued in favor of the status quo.

The Treasury's studies culminated soon after the November elections in the release of a report on fundamental tax reform and simplification. In brief, the plan consisted of a flat individual income tax, modified to include three tax brackets, along with recommendations to eliminate a whole series of deductions used in arriving at taxable

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[1]*Federal Register* 49, 25 May 1984, p. 22171.

[2]Ibid.

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income, and to tax previously tax-free income sources such as Social Security benefits and employee compensation paid in kind. Similarly important recommendations were made for changing the corporate tax code, including a proposal to decelerate the investment write-off periods under the accelerated cost recovery schedule (ACRS). An amended version of the Treasury's plan was subsequently enacted into law and began taking effect during the 1987 tax year.[3]

Despite the fact that the tax reform legislation of 1986 comprehended more provisions of the tax code than usual, it was in reality just the latest installment in what has become an annual Washington rite. Tax legislation has been introduced—and changes in the tax code have been enacted—in virtually every congressional session without recent memory. For example, among its other provisions, the 1981 Economic Recovery Tax Act (ERTA) cut personal income tax rates across the board by 23 percent over three years, and established the ACRS depreciation concept. ERTA was soon considered to have given away too much, so in the following budget year, the Tax Equity and Fiscal Responsibility Act (TEFRA) was approved to provide a tightening of the ACRS standards and to confer on the Justice Department new authority to prosecute sellers of "abusive" tax shelters. In the same year, the debate which led to the most recent tax reform effort was spurred by the introduction of two bills proposing somewhat different versions of a modified flat tax on individual income. These were the Fair Tax Act of 1982 (Bradley-Gephardt) and the Kemp-Kasten "fair and simple tax" (FAST) initiative. Various provisions of the tax code were changed in both 1983 and 1984. In short, tax reform has become a growth industry.

This paper assesses the process of tax reform and simplification within the context of the by now familiar rent-seeking model. The basic point is quite simple. In the current institutional setting, where changes in the tax code are determined by the legislature, repeated efforts at "reform" create a situation in which tax shares are considered "up for grabs" in each and every budgetary period. As a result, the reform process becomes an annual contest among interest groups to preserve existing tax preferences, or to shift tax liabilities to other groups. Realtors, for example, find it necessary in every period to engage in socially wasteful lobbying efforts in defense of the deduction for mortgage interest payments. Similarly, the tobacco industry must continually work against attempts to raise the federal excise tax on its products, and there are frequent efforts by organizations rep-

[3]Although some provisions became effective in January 1986, the major tax reform initiatives began being phased in at the beginning of 1987.

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resenting individual taxpayers to raise the share of taxes paid by corporations. The list could go on.

In such a setting, a case can be made for eliminating taxes on industries that are organized to resist efforts by other interest groups to raise their tax burdens. A relevant example is provided by the federal excise tax on selected goods—automobile tires, beer, cigarettes, and matches, to name a few. Doing away with these levies would save not only the associated deadweight costs, but would in addition substantially reduce the large amount of socially wasteful rent-seeking activity that the tax code presently generates.

The Rent-Seeking Model

Gordon Tullock (1967), recognizing that expenditures made to capture an artificially created transfer represent a social waste, suggested that the cost to the economy of monopoly and regulation exceeds the simple Harberger (1954) deadweight loss. Indeed, under Tullock's original formulation and in the extensions of his work by Anne Krueger (1974) and Richard Posner (1975), rents are exactly dissipated at the social level—$1 is spent to capture $1—so that the total welfare loss from such activities is equal to the Harberger triangle plus the rectangle of monopoly profits. Posner's example is instructive on this point. Suppose that 10 bidders vie for a transfer worth $100,000. If the bids are nonrefundable and the contestants are risk neutral, each will offer $10,000 for the right to be the monopolist. Although the winner will receive a net return of $90,000 on his investment, the monopoly rents are exactly dissipated at the social level because $100,000 is spent in total. The welfare cost of the monopoly thus includes the value of the artificially created transfer.

The tax code also creates wealth transfers, and interest groups will accordingly have an incentive to spend resources in efforts to prevent part of their wealth from being taxed away or to shift some of their liabilities to other groups. They organize, invest in lobbying activities, contribute to political campaigns, advertise their point of view, and so forth. These expenditures reduce the welfare of society as a whole because they are made in pursuit of income redistribution rather than being directed toward income-increasing activities.

Consider the situation depicted in Figure 1.[4] A competitive industry is threatened with the imposition of an excise tax on sales of its product. In the absence of the tax, Q_0 units of the good are sold at price P_0 per unit. If an excise tax of T is levied, however the supply

[4]This model and the analysis in this section are based on the static model developed by Lee and Tollison (forthcoming).

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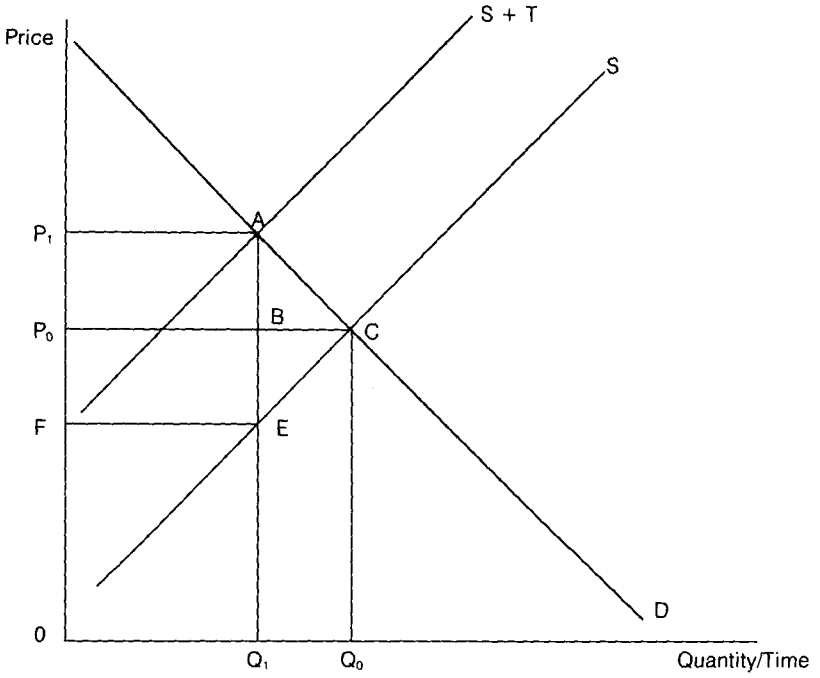
FIGURE 1

RENT-SEEKING MODEL: EXCISE TAX



schedule shifts up by an equal amount (the distance AE in the diagram). Sales fall to Q_1 and price rises to P_1 as a result. The effect of the tax can be decomposed into two parts. First, the excise imposes a deadweight welfare loss (Harberger costs) because output is reduced. The value of this loss is represented by the area of the triangle ACE, and consists of reductions in consumer (ABC) and producer (BCE) surplus. Second, there is a pure wealth transfer (in the form of tax payments) from the private to the public sector. Because the government collects a tax of AE on each of the Q_1 units sold, total tax revenues are equal to the area of the rectangle, P_1AEF. The tax burden is shared by consumers and producers. In particular, consumers pay P_1ABP_0, the tax-induced price increase times after-tax sales. Producers pay P_0BEF; their share can be determined by noting that the tax reduces the price they actually receive on each unit sold from P_0 to F.

The above discussion suggests that producers will be willing to spend up to P_0CEF dollars to prevent the tax from being levied. (Consumers likewise have an incentive to lobby against the tax, but

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their higher costs of organization will usually discourage effective opposition.)[5] This is just Tullock's point in tax space. If by spending $1 producers can prevent $1 from being taxed away, they will be no worse off than if they do nothing and the tax is levied. Accordingly, the potential revenue from the prospective tax bill that would be paid by producers (P_0BEF) is dissipated in nonproductive lobbying activities (Tullock costs). Producers are also willing to spend resources in the attempt to avoid losing their share of the deadweight costs associated with the tax, BCE. In total, then, the welfare cost of the tax (if it is defeated by industry lobbying activities) is equal to the area of the trapezoid, P_0CEF. If the tax is levied, however, the welfare costs are even larger. In particular, the full Harberger loss is borne, so the tax costs society P_0CEF plus ACE. The tax causes the triangle BCE to be lost twice: It contributes to *both* Harberger and Tullock costs.[6]

Exactly the same argument applies to subsidies granted through the tax code. Interest groups will find it worthwhile to lobby for the creation of "loopholes" in the law that reduce their tax liabilities. The value of the resources spent in such efforts will be just equal to the amount of tax relief so gained. It is not necessary to analyze this case in detail because it is the opposite side of the same coin. Holding tax revenues constant, granting a tax preference to one interest group implies that the tax liabilities of some other group will have to be raised by an equal amount. Competition for a tax preference can therefore be analyzed in terms of the symmetrical tax increase.

Up to this point, it has been assumed for simplicity that the distribution of tax shares is determined once and for all. Consequently, each interest group that is threatened with a tax not only dissipates its prospective current tax liabilities in efforts to avoid them, but also the present value of all liabilities expected in the future. If this were the case, little would be gained from a social point of view by reduc-

[5]Becker (1983) relates the amount of taxpayer opposition to the size of the deadweight costs.

[6]The result that the prospective tax bill to be paid by producers is exactly dissipated by nonproductive lobbying activities assumes that the change in the tax code is expected to be perfectly durable, that rent seekers are risk neutral, and that the marginal costs of lobbying are constant. If any of these assumptions do not hold—if, for example, marginal lobbying costs increase with effort—then the extent of dissipation will be less than the value of the revenue rectangle. See Higgins, Shughart, and Tollison (1985) for a theoretical model of rent dissipation. The durability point is discussed in more detail below.

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ing or eliminating taxes once they are in place.[7] As pointed out earlier, however, the present tax reform climate is one in which "the allocation of tax shares among individuals and groups in the economy and the choice of tax instruments that generate the imputations of such shares are considered 'up for grabs' in each and every budgetary period" (Brennan and Buchanan 1980, p. 190). If interest groups must continually fend off attempts by rival groups to increase their tax burdens, then each period's Tullock costs will be smaller. Put another way, if the distribution of tax shares is not durable, favored groups will be forced to spend resources in every period to retain their tax preferences, and other groups will repeatedly spend resources to obtain tax reductions or to prevent their current liabilities from being raised. This means that the Tullock costs are not fully borne up front or, what is the same thing, that the amount of rent-seeking expenditures made in any period will be less than the discounted present value of the Tullock costs.

In the nondurable case, tax reductions (provided they are durable) pay larger dividends in terms of freed resources. Eliminating a tax saves not only the Harberger triangle, but also the present value of the resources spent in future efforts to alter the distribution of tax shares (Tullock costs). In fact, the rent-seeking model has a paradoxical implication for tax reform. The more an interest group spends annually to maintain its tax preference or to prevent its tax burden from being increased, the less durable its tax share is by definition. More importantly, these ongoing expenditures signify that the present value in perpetuity of the Tullock costs associated with the tax has not been completely borne. Therefore, the more an interest group has to spend in tax lobbying activities (holding constant the imputed value of the tax bill), the greater the gain from eliminating (permanently) the tax.

Implications and Conclusions

This paper has used the rent-seeking model to show that the welfare cost of a tax includes any expenditures made by interest groups

[7]The resources expended in lobbying efforts are sunk costs that cannot be recouped. For example, Goetz (1979, p. 800) shows that when loopholes in the law are fully capitalized, "the elimination of tax preferences commonly thought of as constituting horizontal inequities would itself constitute a horizontal inequity." The case of monopoly and regulation is analyzed by McCormick, Shughart, and Tollison (1984). Some parties (consumer-taxpayers, for instance) would of course gain from a reduction in their future tax liabilities. It is nevertheless true that the social benefits from reducing a tax that has been fully capitalized by rent-seeking activities are *less* than the present discounted value of the tax bill.

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to alter their liability under the tax. If the distribution of tax shares is durable, then the present value of the tax payments to be collected from (or the present value of the tax preference to be gained by) interest groups is fully dissipated in nonproductive lobbying activities. Because these expenditures are sunk, little would be achieved by doing away with taxes once they are in place. In the nondurable case, however, only a portion of the Tullock costs are borne in any period. Permanent tax reform would therefore generate relatively large welfare gains. Eliminating taxes that attract ongoing rent-seeking activities by taxpayers would save not only the associated deadweight costs, but would in addition free the resources spent by the affected interest groups in efforts to influence the distribution of tax shares. Moreover, these prospective gains will be larger the larger the expenditures on tax lobbying activities in any period.

It is important to emphasize that the welfare benefits of tax reform identified in this paper can be fully realized only if the reform is truly durable. For example, eliminating an excise tax permanently saves the portion of the deadweight costs imposed on consumers plus the present discounted value of the Tullock costs not yet dissipated by producers. Obviously, the value of the welfare gain will be much smaller if the tax is eliminated this year only to be reimposed two or three years hence.

An implication of the analysis is that relatively large welfare losses are associated with taxing groups that are organized to resist proposed changes in the tax code. More opposition to taxes is predicted to be forthcoming when the taxpayers are small in number, homogeneous, concentrated geographically, and have low organizational costs, than when the taxpayers are large in number, heterogeneous, diffuse, and face high organizational costs. The federal excise taxes are a case in point. These taxes are currently levied on a variety of selected goods and services, many of which are supplied by groups of firms that are well positioned to fight over the distribution of tax shares. (A partial list of these taxes includes the excises on beer and wine, cigars and cigarettes, gasoline and lubricating oils, tires and tubes, white phosphorous matches, fishing equipment, and airline tickets.)[8] The tobacco and dairy lobbies, for example, are well known for their ability to compete in the political marketplace. Any threat to increase taxes or reduce subsidies on these products will therefore create additional

[8]In addition, federal excise taxes are levied on trucks and truck accessories, certain firearms and ammunition, distilled spirits, diesel fuel, life insurance policies, long-distance telephone service, wagers, coin-operated gambling devices, and a few other goods and services. For a complete list, see Pechman (1977, pp. 304–9).

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Tullock costs. On the other hand, the fact that the tobacco and dairy industries spend a relatively large amount of resources annually to influence tax legislation suggests that the social welfare gains from reducing the changes in these taxes or subsidies would be substantial.

A second implication of the rent-seeking model is that periodic tax "reform" generates larger welfare losses than no reform at all. Repeated proposals to change the distribution of tax shares (the nondurable case) create a situation in which Tullock costs must be borne in perpetuity. Excise taxes are also remarkable on this score. The tobacco tax rate, for instance, has been changed 22 times since 1864, each rate being in effect an average of only 72 months.[9] Similarly, soon after the enactment of income tax reform in 1986, some members of the Congress proposed raising the just-lowered tax rates as a way of reducing the federal budget deficit. As Brennan and Buchanan (1980, p. 190) note, in such a setting "the prospective taxpayer is . . . vulnerable to exploitation by government to the maximum limits of his taxpaying capacity." The analysis presented in this paper suggests that the potential welfare gains from (durable) tax reform are greater the more frequently a tax has been changed in the past.

In sum, the rent-seeking model implies that the process of tax reform is too important to be left up to a temporary majority. Tax reform deserves to be considered in a setting where the influence of interest groups is smaller, tax shares are more durable, and the future welfare costs of any tax rules adopted will accordingly be less. A constitutional rule that an increase in the rate or base of any tax may be approved only by a super-majority of the legislature may be the best means to achieve these objectives.

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[9]Because rent-seeking activities will be triggered by any *proposal* to change the tax rate, a true picture of the Tullock costs involved would also include the tax changes considered but subsequently defeated by industry lobbying efforts. McChesney (1987) develops a model in which politicians extract rents by threatening to impose taxes or regulation on private producers, and then are paid to forebear from doing so.

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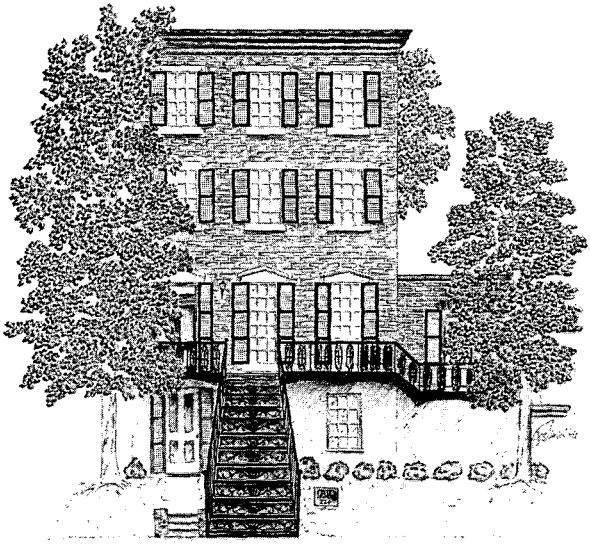

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ON THE WORKS OF P. T. BAUER

There are few branches of development economics in which Bauer has not had something interesting and important to say. And he has gone beyond development economics into the study of comparative economic systems, international economic relations, and general political economy. . . . Bauer's political and economic analysis powerfully illuminates various aspects of international economic relations that are often ignored.

—Amartya Sen

Review of *Equality, the Third World, and Economic Delusion,* by P. T. Bauer. *New York Review of Books* (4 March 1982): 3, 5.

Bauer's message has begun to be heard, not only because of his own perseverance and insights, but also because the repeated failures and massive disasters of "development planning" have finally broken through the smug unanimity that long substituted for evidence or critical analysis. . . .

Bauer is not a mere Scrooge who says "Bah! Humbug!" to the poor. On the contrary, his vision of the world accords far more respect to the less-developed regions and peoples than does the conventional viewpoint.

—Thomas Sowell

Review of *Reality and Rhetoric: Studies in the Economics of Development,* by P. T. Bauer. *Reason* (December 1984): 45.

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